THE ADMINISTRATION OF PUBLIC RETIREMENT SYSTEMS IN THE UNITED STATES

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CHAPTER I

PUBLIC PENSION PLANS AND RETIREMENT SYSTEMS

The use of pensions as rewards, as gratuities, and with charitable objectives has been a phase of governmental activity for centuries. The Bible contains this reference: "And his allowance was a continual allowance given him of the King, a daily rate for each day, and all the days of his life." Six hundred years before Christ, according to verse 30 of chapter 25 of the Second Book of Kings, allowances from the King in the form of pensions were apparently an established custom, and pensions in some form have been in existence ever since.

I. DEVELOPMENT OF RETIREMENT SYSTEMS

Purpose of this study. From their inception pensions were considered to be more or less an obligation of the government to certain individuals or groups. Within the century, however, another idea has developed in the public service. No longer is it assumed, generally, that the government alone shall provide pensions for aged public employees. As a result, retirement plans have been established in which the employees participate by making some contribution to their expected retirement allowances.

The evolution of these public retirement systems has been very sporadic and many hundreds of small independent systems have been established, usually at the insistence of the employees themselves, without adequate planning as to proper objectives and the techniques by which those objectives are to be attained.

Much has been written about public pension plans and retirement systems, and from this literature the purposes and general procedures essential to a sound system may be determined. Apparently, however, the problems and methods of retirement system administration and management have not been considered apart from the general phases of retirement plans.

There is reason to believe that a study of administrative and management experiences and practices can be useful in projecting uniform methods of control and procedure. It is fairly obvious that much of the current questioning on the part of taxpayer groups and retirement system members may be attributed to the ineffective and loose management which has been experienced by the majority of systems.

How are the administrative bodies set up, what are their functions, and how do they operate? What investment policies and programs are followed? What controls, such as periodic audits, are maintained? What qualifications should be required of management personnel and what are the essential techniques of management? These and other similar questions are important to the subject.

This study has been attempted, therefore, for the purpose of ascertaining the experiences of present systems and to develop, if possible, from these experiences criteria of administration and management. In order to provide a proper background for the discussion, a brief history and description of pension systems is given in this chapter.

II. HISTORY OF PENSIONS AND RETIREMENT SYSTEMS

Military pensions. Throughout history it has been the custom of peoples to reward their soldiers or the families of soldiers as a token of gratitude for the sacrifices they may have made in defense of the government.

In America the first pension plan of record was enacted by the Plymouth Pilgrims in 1636 and provided that a soldier who "returned maimed" should be provided for by the colony for the remainder of his life. Later, in 1644, the Assembly of the colony of Virginia provided disability pensions for disabled soldiers. In order to encourage enlistments in General Washington's army, the Continental Congress on August 26, 1776, passed what is recognized as the first real pension law in the United States.[1] This law was but the beginning of a series of federal and state pension laws which were enacted to provide for soldiers and their families. Data concerning these laws may be found in the Reports of the United States Commissioner of Pensions.

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[1] Amos W. Butler, "Government and Municipal Pensions," National Conference of Charities and Corrections, Proceedings, 1906, p. 470.

<u>Public service pension laws</u>. Although the problem of pensions for soldiers has been recognized since "the time of the first crusade,"[2] a recognition of any such rights for civil employees was slow in appearing.

In Great Britain the first general pension law for central government employees was passed in 1810. In France the basic general law providing pensions for civil employees was not adopted until 1853, although certain groups of government employees were covered by specific grants at an earlier date. Other European countries that enacted general pension laws in those early years in recognition of the need for public retirement systems were Belgium (1844), Italy (1864), and Germany (1873).[3]

Agitation for a pension plan for employees of the central government in the United States began in 1845 and continued sporadically until May 22, 1920, when Congress finally passed the Federal Retirement Act to provide retirement annuities for employees of the national government. Several states had passed legislation which provided pensions for limited groups of employees, but Massachusetts was the

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[2] Henry S. Pritchett, <u>A Comprehensive Plan of Insurance and Annuities for College Teachers</u> (New York: Carnegie Foundation for the Advancement of Teaching, Bulletin No. 9, 1916), pp. 6 f.

[3] William E. Mosher and J. Donald Kingsley, <u>Public Personnel Administration</u> (New York and London: Harper and Brothers, 1936), p. 444.

first state to enact general pension legislation to cover all those directly employed in the service of the state. This Act was adopted in 1911, and it was not until 1919 that Connecticut and Maine enacted similar legislation, to be followed by New York in 1920, New Jersey in 1921, and Pennsylvania in 1923.[4]

Police and firemen were the first municipal employees to be granted pensions by cities and towns. These public employees were favored largely because of the hazardous nature of their occupations. The first municipal pension fund of record, established by law, was that for New York City policemen in 1857. Later, in 1871, New York City passed a law providing pensions for firemen. With these beginnings greater interest in pensions for municipal employees, largely through the organized effort of the employees themselves, was created. If the firemen and police were entitled to pensions because their employment subjected them to danger and exposure, how about street cleaners whose risks were also great? or health officers? or clerks grown blind in maintaining the city's records? or, in fact, all employees worn out by long service for the municipality? A survey made in 1910 found that two hundred nineteen municipal funds were in

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[4] "Retirement Systems and Morale in Public Service," Annals of the American Academy of Political and Social Science, 113:339, May, 1924.

existence, all of which applied to special groups of employees.[5]

The school teachers of New York City assumed the leadership as early as 1879 in a program to secure pensions for aged teachers. Their continued efforts were thwarted until 1894 when the State Legislature enacted a retirement law, the first in the United States for public school teachers.[6] Similar pension plans were presently adopted by other cities in the state and by school systems in other parts of the country, until in 1937 it was estimated that some 65 per cent of all teachers in the United States were members of retirement systems and pensions plans.[7]

II. DEFINITIONS OF TERMS

Pension plans. The original motive for the granting of allowances by a king or feudal lord to his soldiers or retainers was to reward faithful service. In later years a military pension was granted to a wounded soldier, or to the family if the soldier lost his life in service, as a payment

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[5] "Pension Systems for Municipal Employees and Railroad Pension Systems," in United States Senate Document No. 427, 61st Congress, 2nd Session; quoted in Mosher and Kingsley, op. cit., p. 446.

[6] A Study of the New York State Teachers Retirement System (Albany: New York State Teachers Association, 1939), p. 3.

[7] Teachers Retirement Systems and Social Security, National Education Association, Research Bulletin No. 15, 1937, p. 94.

for sacrifices made. The idea of rewarding faithful service still persisted when pensions were provided for other employees of the government, but it must be admitted that many early pension systems were predicated upon relief for old or incapacitated employees as a charity measure.

These early pensions were paid entirely from the public treasury and therefore should properly be termed pensions in accordance with the recognized definition in Webster's New International Dictionary:

> A stated allowance or stipend made by a government or business organization in consideration of past services, . . . to one retired from service; especially a regular stipend paid by a government to retired public officers, disabled soldiers, the families of soldiers killed in service, . . .

Retirement systems. In recent years recognition has been given to the employees' share of the responsibility in financially providing for his retirement from public service. As a result, retirement annuities and disability benefits in many systems are provided for through contributions by both the governmental unit and the employees. In much of the literature on the subject of pension funds and retirement systems these terms are used interchangably; however, a distinction should be made to avoid confusion. "Pensions" should apply to payments made by the governmental unit from the public treasury. "Retirement annuities" or "allowances" should describe payments made from a fund created by the contributions of both the governmental unit and the employee.

III. OBJECTIVES OF RETIREMENT SYSTEMS AND PENSION FUNDS

Past objectives. The public pension and retirement movement has been evolving gradually, therefore, the objectives in providing a pension fund or in establishing a retirement system have changed through the years. We of this nation are a sentimental people. We quickly become concerned over the problems of the aged and disabled, with the result that pensions were formerly supported on the bases of gratitude, rewards, aid, relief, and, sometimes, pure charity.

Present objectives. The present attitude toward pension funds and retirement systems is more and more coming to be based upon economic and social considerations. For the employee, the primary objective in the retirement or disability allowance is to help create a sense of economic security and relief from anxiety for the future, for self and family; " . . . to provide a means whereby civil servants may leave the civil service at the end of their careers in as orderly a manner as they entered at the beginning."[8] The primary objective in establishing a retirement system, from the point

[8] Lucius Wilmerding, Jr., Government by Merit (The Commission of Inquiry on Public Service Personnel, Monograph No. 12; New York: McGraw-Hill Book Company, Inc., 1935), p. 202.

of view of the government unit, is the improvement of its staff.[9]

Other objectives, such as the termination of the employment of men and women who through age or disability are no longer reasonably efficient, the attracting into public service of a higher grade of personnel by the promise of adequate benefits, and the raising of morale through opportunities for promotions, are related to the primary objective but subordinate to it and need no elaboration here.

The principal reason for the establishment of a sound retirement system in the interest of the public is to eliminate the cost of so-called hidden pensions. The public, generally, will not countenance the discharge of an old or incapacitated employee without means, after a lifetime spent in public service. If no pension has been provided, there is nothing else to do but to continue the employee on the active payroll at full salary regardless of his lack of ability to earn that salary. It is not possible to estimate the expense to the public in these unearned salaries, or hidden pensions, but it is reasonable to assume that the cost is more than that of adequate pensions.

Lewis Meriam in his book on the retirement of public employees succinctly sums up the principal objectives in a retirement system as follows:

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[9] Mosher and Kingsley, op. cit., p. 447.

> The important points are to adopt a system . . . that will meet the needs of the service to which it is applied, that will be just to the employees as a class and to individual employees, and that will receive the approval of a public enlightened as to the possibilities of a retirement system as a social insurance device, the benefits of which are earned by the employees.[10]

The interests of the employee, of the governmental unit, and of the public in any retirement system can be furthered best by establishing and maintaining a retirement system on sound economic and social principles. No longer is there any defense for the pension fund which is based on relief and charity to the employee.

IV. EXTENT OF PRESENT SYSTEMS

Municipal systems. During the eighty-four-year period since the establishment of the New York City Police Pension Fund in 1857 the growth of pension funds and retirement systems for public employees has been quite extensive. The majority of these until within the last twenty years provided, however, for only police and firemen.

A survey made in 1938 by the staff of the International City Managers' Association sought to determine the extent of municipal retirement systems as well as to ascertain certain basic information concerning them. Replies to a questionnaire

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[10] Lewis Meriam, Principles Governing the Retirement of Public Employees (New York; London: D. Appleton and Company, 1918), p. 450.

returned by 819 municipalities indicated that 545 pension funds and retirement systems were in effect in 519 cities of over ten thousand population. Forty-seven additional cities replied, but the answers were too incomplete for inclusion in a summary of the survey. These, however, should be added to the total number of systems in effect as also should forty known systems which did not reply. The total number of pension and retirement funds in effect in cities of ten thousand population or over in 1938, therefore, was 632.[11] The distribution of these systems in cities according to population is shown in Table I.

State systems. This same survey determined that twelve states had state-wide systems for all public employees exclusive of public school teachers. The states in the order of the inauguration of their systems were: Massachusetts, 1911, Maine, 1919, Connecticut, 1919, New York, 1920, New Jersey, 1921, Pennsylvania, 1923, Minnesota, 1929, California, 1931, Colorado, 1931, Rhode Island, 1936, Maryland, 1937, and Ohio, 1938.[12]

Teachers' systems. The development of pension plans

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[11] "Municipal Retirement Systems," Municipal Year Book, 1938 (Chicago: International City Managers' Association, 1938), pp. 310-318.

[12] Loc. cit.

TABLE I

MUNICIPAL RETIREMENT SYSTEMS BY POPULATION GROUPS

Population group	Number of cities	Number of systems
Over 500,000	13	23
200,000 to 500,000	26	30
100,000 to 200,000	53	54
30,000 to 100,000	195	203
10,000 to 30,000	319	322
Totals	606	632

and retirement systems for public school teachers has been somewhat more extensive than those for general public employees since the first retirement law was enacted for New York City teachers in 1894. The National Education Association reported in 1937 that twenty-three states, Hawaii, Puerto Rico, and the Canal Zone had state-wide systems in operation and that several other states were contemplating the establishment of systems. Also, fifty-six local plans in cities and counties were reported.[13]

This report indicated that retirement allowances were provided for teachers under the several plans as follows:[14]

Under joint-contributory plans	60.4 per cent
Under noncontributory plans	.8 per cent
Under system without public funds	4.5 per cent
With no retirement allowances	34.3 per cent

Civil service retirement and disability fund. It was not until 1920 that the Congress of the United States passed legislation establishing a retirement system for federal employees. This Civil Service Retirement and Disability Fund is the largest public retirement system in the world and at the close of the fiscal year, June 30, 1938, had an active membership of five hundred forty thousand.[15]

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13 Teachers Retirement Systems and Social Security, op. cit., pp. 91-151.

14 Ibid., p. 94.

15 Eighteenth Annual Report of Board of Actuaries, Civil Service Retirement and Disability Fund (Washington, D.C.: United States Government Printing Office, 1939), p. 5.

V. TYPES OF RETIREMENT SYSTEMS AND PENSION PLANS

Form and structure. Retirement systems and pension plans vary in type and in organization. Some are joint contributory, others are noncontributory. Many have been established on a cash disbursement basis; fewer are organized on an actuarial reserve basis. Benefit allowances may be provided for old-age retirement, for death, either natural or in line of duty, for disability, or for the widows and children of deceased employees.

The beginnings of pension legislation in the United States were not sound. Laws had their inception at the hands of groups of employees who were more concerned with the relief of their own anxiety concerning the future than with the soundness of the systems they endeavored to establish. After framing a bill, the next step was to have it introduced by a friendly legislator, who in turn would secure its passage through political pressure or through a sympathetic plea of compassion for the proposed beneficiaries. Thus, very little or no consideration was given to public employees in general, to the interest of public service, or to the financial soundness of the fund or system.[16]

Noncontributory plans. These early pension plans

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[16] Paul Studensky, "Pensions in Public Employment," *National Municipal Review*, 11:97-124, May, 1922.

usually required no contributions from employees and no reserves were accumulated for the payment of future benefits. The public, if it was considered, thought of pensions largely as charitable contributions to public employees. Paying half salary as a pension to an old employee eligible for retirement instead of continuing his whole salary seemed a saving in taxes at the time.

Under the noncontributory plan, the governmental unit pays all of the pension and usually no provision is made for the cost of a pension until an employee is eligible for retirement. Experience has shown that most plans of this type eventually become such a financial burden to the public that they are discontinued or the benefit allowances to the retiring employees are drastically reduced.

Contributory plans. Groups of employees have sometimes established pension plans and benefit associations in which all pension payments and benefit allowances are contributed by the members. These plans generally have proved unsatisfactory because of the high cost to each active member and the difficulty of making the plan compulsory.

In joint-contributory retirement plans, the governmental unit and the employees each make contributions to the costs of benefit allowances, and each, therefore, has a fundamental interest in the proper maintenance of the fund and in its administration.

Cash disbursement plan. Joint-contributory retirement systems may operate under one of two main types of financing plans, the cash disbursement basis or the actuarial reserve basis.

The cash disbursement plan presupposes contributions from employees and the governmental unit sufficient to meet anticipated benefits for any one year, and usually no advance provision is made for future benefit payments. If, for example, the expected benefit payments for a given year are $100,000, approximately that amount of money will be paid into the fund from all sources for that year.

The cash disbursement plan is criticized largely because it does not contain within itself the element of perpetuity. This claim is made for the reason that during the first years of the operation of a retirement system only a few members retire, therefore, the amount of money needed to pay benefit allowances is comparatively small. As the system grows older, more and more members become eligible for benefit allowances and the total amount of money necessary to meet the additional payments each year increases substantially. If the governmental unit cannot carry the resultant financial burden and the members oppose an increase in their contributions, benefit allowances must be reduced or the fund will become insolvent.

Meriam proposes two favorable arguments for the cash disbursement plan that suggest simplicity and safety: "No elaborate collecting and investing machinery is required and no nice actuarial computations and valuations are needed. The money is left with the taxpayers until needed thus obviating incidentally a loss through mismanagement or bad investment."[17] It may further be suggested that when there is no question of the financial adequacy or the good faith of the governmental unit, such a system can be reliable.

The cash disbursement plan is objected to on the grounds that it is unbusinesslike and may be extravagant, that during times of economic stringency the necessarily increased appropriations by the government subject it to public criticism, and that future generations must bear the financial responsibilities incurred by the generation which established the system. Possibly the most serious defect is the first one mentioned, since at the start "the apparent absence of financial burden makes it relatively easy to obligate the government to costly benefits, the expense of which is obscured until later years."[18]

Actuarial reserve plans. In systems that operate on an actuarial reserve basis, contributions from employees and

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[17] Meriam, *op. cit.*, p. 328.

[18] Leonard D. White, *Introduction to the Study of Public Administration* (New York: The Macmillan Company, 1939), pp. 407-8.

from the governmental unit are paid into reserve funds. The future costs of benefits and allowances are calculated from mortality and other experience tables so that the accumulated contributions, invested at compound interest, will result in a sufficient reserve to retire members upon their reaching the retirement age. The same general rules are followed in setting up the reserves as those under which the safer insurance companies operate. These give the fund a reasonable measure of security, making it possible for the governmental unit to plan approximately for its share of the necessary financing in future years as well as for present needs.

Objections to the actuarial reserve plan are based upon the multiplicity of essential records, the complexity and cost of necessary computations to determine future probabilities, and the need for adequate investment machinery. To these may be added the difficulties which may be experienced through political control of a large reserve fund, the possibilities for dishonest or careless management, the prospect of financial losses through unwise investments, and the difficulty of maintaining full reserves with the present low interest rates.

An advantage to be found in the actuarial reserve plan lies in the possibilities of determining the true costs of future benefits. The present generation of taxpayers, therefore, pays for the services which are rendered to it and does not defer the financial burden to succeeding generations. Also, a share of the cost of eventual benefits should come from interest earned on the funds invested. The interest received lessens the otherwise necessary contributions of both employees and employer. Under present conditions the actuarial reserve plan appears to be the safest and most equitable for governmental units, for employees, and for the taxpayer.

VI. EXPERIENCE OF PENSION FUNDS AND RETIREMENT SYSTEMS

Difficulties encountered. The establishment of the pension fund for New York policemen in 1857 on an unsound basis opened an era during which numerous public pension plans and retirement systems were organized without proper consideration being given to their financial planning. It was one thing to promise attractive future benefits; it was quite another to adequately finance those benefits from the long range point of view. Only after some years did the increasing financial burden imposed on governmental units become apparent.

The experiences of many if not all of the early systems were similar. Where the governmental unit at the start paid all of the cost of the pensions, the financial burden after a few years became so heavy that the taxpayers revolted. Pension systems were then set up on a joint-contributory basis with all contributions being paid into a common fund from which the benfits, whether retirement, or disability, or death, or all of these, should be paid. With but few beneficiaries during the first years, the fund in most cases increased substantially, or, if a reserve was not built up, the present cost to employee and employer was negligible.

After some years the number of beneficiaries naturally increased so that benefit payments exceeded contributions. If there was a reserve fund, this gradually became depleted or, in fact, wiped out by the increased benefit payments. The remedies used to stabilize the system were usually one or more of the following: reduce the benefit allowances, let the governmental unit assume the increased costs, increase the employees' contribution along with those of the government, or reorganize the system on an actuarial reserve basis. Many, if not most, pension funds and retirement systems have gone through or are going through one or more of the above phases; only the last plan, however, has proved satisfactory, and the tendency in public retirement systems during recent years has been toward the actuarial reserve plan.

Excerpts from surveys. The status of pension funds and retirement systems in several sections of the country during various periods can best be attested to from the results of investigations and surveys which have been made. These examples give a background for the experience of most funds.

The Pension Commission of New York reported in 1917: "In not one single city in the United States that has established provision for aged and infirm policemen, firemen, schoolteachers or others was the system based on sound actuarial principles."[19]

A report in 1918 concerning pension funds in Illinois has this to say:

> These acts have been built up blindly. The liabilities under them have crept up almost imperceptibly, as the service given by the public as an employer has expanded. Through these laws the state and many of its municipalities today are in effect in the position of holding out dishonest promises to the men and women in the employ of the public . . .[20]

Seventy local pension plans in the state of New York were studied in 1931, none of which were found to be actuarially sound.[21]

In his report on retirement systems in Virginia, Roland Egger wrote:

> The Statute establishing the . . . system is one of the most quixotic bits of wishful thinking in the annals of legislative imponderabilia; its administration has been as fantastic as its original pattern, and its utter bankruptcy has been assured from the outset. The two . . . systems have likewise been

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[19] Lawson Purdy, "Municipal Pensions," National Municipal Review, 7:14-17, January, 1918.

[20] White, op. cit., p. 409.

[21] Albert H. Hall, A Summary of Actuarial Surveys of Seventy Local Police and Fire Pension Funds in New York State (Albany, New York: New York State Conference of Mayors, Publication No. 34, 1935), p. 10.

> bankrupt since the day of their inauguration. Three others are headed toward annihilation when the true magnitude of the burden they have assumed becomes apparent.[22]

Individual examples. In attempting to secure material for this study information was sought from the managers of several pension funds and retirement systems. A few of the replies received are worthy of being cited because they so clearly indicate the difficulties being encountered by certain funds and systems. It is not suggested that these examples are typical of most pension funds and retirement systems, but from information available they may well describe the situation of many funds.

Inasmuch as the replies received were confidential in their nature, the full statements are given in Appendix II without identifying either the authors or their retirement systems.

Retirement system managers are critical of their respective systems for several reasons, such as: a failure adequately to plan the system, selfish employees and politicians prevent reorganization plans, the systems are largely political set-ups, retirement ages are too low, benefit allowances are too large, employees do not contribute an equitable amount, governments contribution is too heavy,

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[22] Roland Andrews Egger, The Retirement of Employees in Virginia (Studies in Public Administration No. 1; New York: D. Appleton-Century Company, 1934), p. 1.

reserves are being dissipated rapidly. One manager reported that the cost of retirement benefits had doubled in ten years from thirty thousand to sixty thousand dollars, which amount was entirely too great for the municipality. Another stated that the system was "going in the red" every year.

Failure of objectives. An examination of existing pension funds and retirement systems would reveal, generally, that they have been established at the request of, and for the benefit of, different groups of employees without any adequate understanding of the purposes to be served and the costs which would be involved. Unfortunate experience has shown that time and again employees who have been looking forward to a pension payment or retirement allowance as a protection in old age have found themselves without that protection because of the insolvency of the fund. Certainly an unsound system with its probability of disappointment to its members is worse than no system at all. Disappointment creates discontent and lowers the employee morale. The governmental unit is placed in the difficult position of not meeting its promised obligations and, therefore, the fundamental objectives of a public retirement system; those of economic security for employees and the improvement of staff are not attained.

VII. REASONS FOR THIS STUDY

Sound retirement system essential. A retirement allowance for the public employee is recognized generally as a condition of employment in the public service. This being so, all employees of governmental units should within a few years be included in some type of system.

There no longer is any excuse for establishing a retirement system on a guess basis; and one of the principal aims of those who are interested in the sound administration of public affairs is the reorganization of present unstable pension funds. Much has been accomplished toward this end, and many systems, particularly those in the larger governmental units, have within recent years placed their retirement systems upon a sounder basis. This is not as a rule an easy task for the reason that the possible beneficiaries will oppose any necessary reduction in retirement allowances, political interests may impede any progressive action, and the problem of incurred liabilities must be faced.

Retirement systems show a remarkable lack of uniformity in their general provisions and methods of operation. This situation is due, in the opinion of Henry S. Pritchett, to attempts to bridge the gap between the unsound provisions of an older system and the better provisions of the new system. Compromises have been made advisable or unavoidable by the necessity of adjusting ideal provisions to personal and economic conditions.[23]

Standards of operation. Recognizing that present unsound systems cannot be changed overnight, it would still seem appropriate to endeavor to establish some standards for uniform operation toward which systems going through a period of transition could strive. In addition, by reference to such a pattern new systems might avoid the mistakes of older systems.

One manager wrote: "We cannot be of much help to you except to hope that you will profit by our mistakes." This seeming apology strikes the very keynote of possible progress in the field of pension funds and retirement systems. Furthermore, it provides the basis upon which this study is predicated. Present adequate systems are better and stronger than those of earlier years because earlier mistakes have been avoided and the experience gained through those mistakes has been useful. It was felt, therefore, that a compilation and study of the experiences and practices of several pension funds and retirement systems would prove valuable in any effort to establish standards in certain phases of operation.

Phases of retirement systems. The phrase "certain

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[23] Henry S. Pritchett, The Social Philosophy of Pensions (New York: Carnegie Foundation for the Advancement of Teaching, Bulletin No. 25, 1930), pp. 38-40.

phases of operation" is used advisedly. An entire chapter could be written on each of several subjects pertinent to the functioning of a retirement system, such as the relative merits of the cash disbursement plan versus the actuarial reserve plan, contributory versus noncontributory plans, the determination of contributions by employees and the governmental unit, the problem of accrued liabilities, the essential benefit features of a system, and others. These with their several ramifications have been well covered in existing books, articles, and reports, and are mentioned only incidentally in this study for the purpose of elaborating other phases which are discussed more in detail.

Administration and management factors. When a retirement system is established, certain agencies for its proper functioning must be supplied. Unfortunately, complete and adequate provisions pertaining to administration and management are seldom included in the enabling legislation under which a system may operate. Those charged with the responsibilities of administration and management have often, as a consequence, developed procedures by trial and error methods.

Where the collection of many contributions, the accounting for and auditing of numerous records, and the investment of large reserves are involved, the risk is too great to leave to inexperienced personnel and experimental procedure.

In substantiation of this assertion, the experiences of those responsible for three pension funds are of interest. A city treasurer made the following statement: "The Fireman's and Police Pension Acts have been administered by appointees in many cases with no training in the handling of funds and securities."[24]

This comment was made by the secretary of a retirement system:

> I installed the . . . System fourteen years ago and have had many experiences which you could avoid if an experienced man did the work and trained the staff from the beginning. We have had a number of things turn up that had we the previous experience could have been avoided.

Another secretary wrote:

> Your system should be operated by an experienced man as many mistakes are made at the installation of a system which cause much trouble in after years. . . . It is a highly specialized work requiring constant study and a detailed follow up.

As has been indicated, earlier pension funds were largely predicated upon relief and aid for public employees. Very little thought was given to administration, planning, and financing. It is possible that the major emphasis should still be placed on the problems incident to personnel, but, if the functions of administration are neglected, a system may fail properly to serve its constituents.

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[24] These and other statements by the secretaries of pension funds and retirement systems used in this study were given in confidence; for this reason the writer's name and his city have been omitted.

Objective of this study. Sound administration is imperative in any present-day form of public service if the governmental unit is to justify its right to support from the public it serves. Retirement systems, because of their import to public servants and their dependence upon the pocketbooks of taxpayers, should be particularly free from criticism in administration.

If the experiences of past programs are to be of value to future projects, those experiences must be catalogued and appraised, and, if possible, standards of conduct for successful operation should be developed from them.

It is this thought that motivated the present study of the functions of administration of retirement systems and the machinery which has been set up for their execution. The aim of the study is to make use of the administrative practices, both positive and negative, of existing pension funds and retirement systems in an attempt to establish a pattern for sound administration.

Sources of information. There is a large amount of available literature on the subject of pension funds and retirement systems in the form of books, articles, surveys, studies, reports, et cetera. Many of these have been most helpful in providing background and explanatory material.

Most of the information used in this study has come from existing retirement plans, from correspondence and interviews with persons responsible for their administration, and from annual reports, enabling legislation, ordinances, by-laws, and informational pamphlets.

The factual data for the most part were derived from the returns to questionnaires sent out to the managers of several funds and systems.[25]

Organization of this study. The administrative functions connected with the operation of pension funds and retirement systems fall into several groups, such as general administration, finance, investment, actuarial, the secretariat, public relations, personnel, and others. The objective here is concerned primarily with the details and procedures of operation and only incidentally with the problems of membership personnel.

The following chapters have been organized so as to cover as thoroughly as possible the subject matter suggested by the chapter heading.

In Chapter II is shown the results of a survey of public retirement systems undertaken to secure material for this paper. They provide a substantial foundation of data for later consideration.

Under the subject "General Administration of Public Retirement Systems," the functions, types, compositions, and

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[25] See Appendix I for a copy of the questions used in the survey.

effectiveness of administrative boards are discussed in Chapter III.

The source of, method and cost of collecting, manner of accounting for, and responsibility for, funds are considered in Chapter IV, "Financial Management of Public Retirement Systems."

The attempt is made in Chapter V, "The Investment of Public Retirement System Funds," to show practices and problems incident to investing surplus funds.

Chapter VI, "Management Problems and Practices," has as its purpose the indicating of the functions, the problems, the machinery, and the effectiveness of management operations in retirement systems.

The "Civil Service Retirement and Disability Fund" is reviewed in Chapter VII.

In Chapter VIII, "Evaluation of Public Retirement Systems," a summary of available material is made so as to set forth the fundamentals of, and if possible develop criteria for, sound retirement system administration and management.

CHAPTER II

A SURVEY OF PUBLIC RETIREMENT SYSTEMS

In approaching the subject of administration in public retirement systems the general problem which arose was to procure sufficient material for classification and discussion. So many and varied are the phases incident to retirement systems that tabulation of them is difficult, and, furthermore, some are not amenable to research through the questionnaire method alone.

Other similar studies conducted by means of questionnaires were quite successful in accumulating general data. It was felt that if such data could be supplemented by information derived through interviews and correspondence, adequate material could be collected for satisfactory research on the subject.

This chapter presents a summary, under several classifications, of the returns received from a questionnaire survey. The contents of the chapter may be criticized for their statistical nature. The data do form, however, a basis for later discussion and in this respect may well be considered important.

I. METHOD OF PROCEDURE

Survey by questionnaire. The material received through replies to the questionnaire was supplemented by interviews and correspondence with the secretaries of several systems. In this way many points that seemed ambiguous in the questionnaire replies were clarified. Interviews with retirement system secretaries, public administration officials, actuaries, and investment counselors elicited much information of value. Mention has already been made concerning the use of literature in the field of pension funds and retirement systems. From it a background for an understanding of retirement system administration problems and practices was gained.

Another problem to be met in projecting the survey was to secure enough data and information to warrant substantial conclusions. The International City Managers' Association for years has kept closely in touch with public pension and retirement systems, and a survey published in 1938 by this organization provided a list of municipal and state systems to which questionnaires could be sent.[1]

A list of retirement systems for teachers--state, county, district, and municipal--was secured from a published survey directed by the National Education Association.[2]

Variety of systems. The greater number of active

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[1] "Municipal Retirement Systems," Municipal Year Book, 1938 (Chicago: International City Managers' Association, 1938), pp. 310-18.

[2] Teachers' Retirement Systems and Social Security, National Education Association, Research Bulletin No. 15, 1937, pp. 91-151.

pension funds and retirement systems has been established to provide benefits for police and firemen. This may be attributed largely to the early attention received by these classes of employees from a public sympathetic to the dangers in their employment. Teachers also have been active in establishing organizations through which they could procure retirement and other benefit allowances. Other groups of civil employees gradually succeeded in providing themselves with some kind of pension plan, until there are now in existence retirement systems, sometimes several within a given governmental unit, covering most, if not all, classes of public employees.

The functions of administration of these funds may be similar, but the objectives are often dissimilar. Therefore, in attempting to secure information about administration and management operations, it was considered important to test a cross section of pension funds and retirement systems through two classifications: employee groups and population of the governmental unit.

Classification of systems. Six classifications of systems by employee groups were chosen to be used in the survey: (1) police, (2) firemen, (3) police and firemen, (4) teachers, (5) general, those employees not included in any of the previous groups, and (6) all. In the last classification, all employees of the governmental unit are eligible for membership in the system.

Other employee groups having systems in some governmental units are librarians, street cleaners, and public utility workers. There are not a sufficient number of these systems to make another classification; therefore, they were not considered.

The population classification was used in an effort to determine the differences, if any, in administrative problems and practices in larger systems as contrasted with smaller systems. Ranging from the state-wide unit down to cities of ten thousand population, six classifications are used: (1) state-wide, (2) cities over five hundred thousand population, (3) cities from two hundred thousand to five hundred thousand population, (4) cities from one hundred thousand to two hundred thousand population, (5) cities from thirty thousand to one hundred thousand population, and (6) cities from ten thousand to thirty thousand population.

Questionnaire distribution. Questionnaires were mailed in May, 1940, to three hundred twenty-nine pension funds and retirement systems. Twenty-nine questionnaires were sent to state teachers' retirement systems and twenty-five were sent to systems which included all state employees. Questionnaires were mailed to municipal retirement systems as follows: to cities over five hundred thousand population, twenty-seven; to cities having a population of two hundred thousand to five hundred thousand, thirty-six; to cities with a population of one hundred thousand to two hundred thousand, fifty-nine; to cities of thirty thousand to one hundred thousand population, one hundred and twenty; to cities with a population of ten thousand to thirty thousand, thirty-three.

A summary of the number of questionnaires mailed and the number of replies received is shown in Table II.

Replies to the questionnaires. Replies to the questionnaires were received from one hundred eighty-three systems, or 55.6 per cent of the total number mailed. One hundred forty-six systems, or 44.4 per cent, did not reply.

Of the number of questionnaires which were filled out and returned, forty-nine, 14.9 per cent, were not sufficiently complete to be of real value. The specific information and data used in this study, therefore, were taken from one hundred thirty-four replies, or 40.7 per cent of the number of questionnaires distributed.

As was expected, the greater number of significant replies was received from the larger systems. This may be attributed to better staff organizations than the smaller systems can command. In one classification, however, this did not hold true, as only seven satisfactorily completed questionnaires, 28 per cent of the number sent out, were returned by all-employee state systems.

Satisfactory replies from systems by population groups

TABLE II

SUMMARY OF QUESTIONNAIRES SENT OUT AND REPLIES RECEIVED BY POPULATION GROUPS

Population classification	Blanks mailed	Usable replies	Replies no value	No reply	Per cent usable
State, teachers	29	16	6	7	55.2
State, all	25	7	5	13	28.
Cities over 500,000	27	24	1	2	88.8
200,000 to 500,000	36	18	10	8	50.
100,000 to 200,000	59	24	13	22	40.6
30,000 to 100,000	120	31	13	76	25.8
10,000 to 30,000	33	14	1	18	42.4
Totals	329	134	49	146	
Per cent	100	40.7	14.9	44.4	40.7

were: cities over five hundred thousand population, twenty-seven, or 88.8 per cent; state teachers, sixteen, or 55.2 per cent; cities of two hundred thousand to five hundred thousand population, eighteen, or 50 per cent; cities of ten thousand to thirty thousand, fourteen, or 42.4 per cent; cities of one hundred thousand to two hundred thousand, twenty-four, or 40.6 per cent; state all-employees, seven, or 28 per cent; cities of thirty thousand to one hundred thousand population, thirty-one, or 25.8 per cent. The numbers of returned questionnaires by population groups are shown in Table II, on page 36.

Replies by employee group classification. Table III gives a summary of replies to the questionnaire by employee groups according to population classification. Of the one hundred thirty-four systems that returned completed questionnaires, thirty-five, 26.1 per cent, were teachers' organizations; thirty-three, 24.6 per cent, were from all-employee systems; general employee groups returned nineteen, 14.1 per cent; eighteen questionnaires, 13.5 per cent, were sent from police and firemen funds; police pension funds and retirement systems returned eighteen, 13.5 per cent; and, eleven replies, 11 per cent, came from firemen funds and systems.

II. STATISTICAL RESULTS OF THE SURVEY

Subject matter of the questionnaire. The third problem

TABLE III

SUMMARY OF REPLIES TO QUESTIONNAIRE
BY EMPLOYEE GROUPS

Population classification	All	General	Police and fire	Police	Firemen	Teachers
State, teachers						16
State, all	7					
Cities over 500,000	2	8	2	5	2	5
200,000 to 500,000	3	2	1	5	3	4
100,000 to 200,000	3	6	2	5	4	4
30,000 to 100,000	8	3	13	2	2	3
10,000 to 30,000	10	0	0	1	0	3
Totals	33	19	18	18	11	35
Per cent of total	24.6	14.1	13.5	13.5	8.2	26.1

incident to a survey of basic information concerning the administrative functions of retirement systems was to prepare the questionnaire. Two considerations were of importance and they were in opposition to each other. One was to include in the questionnaire a sufficient number of pertinent questions, brief answers to which would supply the desired information. The other was to cover the subject matter with as few questions as possible so as to be reasonably certain that time would be taken by fund secretaries to complete the answers.

The subject matter of the questionnaire should positively relate to the aim of the survey, which is to make use of the administrative practices of pension funds and retirement systems in an attempt to establish a pattern for sound administration.

Under the title, Questionnaire for the Study of Problems of Administration and Management of Public Retirement systems,[3] the four-page printed blanks, which included a form letter on the first page, were addressed to the managers of three hundred twenty-nine pension funds and retirement systems.

Sixty-six questions were listed under eight headings: General Administration, Financial Management, Office Management, Investment Program and Experience, Actuarial Advice and

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[3] Note: The contents of the questionnaire will be found in Appendix I.

Experience, Operation Statistics, Relations with Public and with Members, and General Information and Remarks.

A most interesting source of frank information was the blank page to be used for the remarks and recommendations of the person who filled out the questionnaire. Most of the confidential statements quoted in this paper were taken from this page of the questionnaires which were returned.

Unless otherwise noted, the information and data taken from the completed questionnaires applies to the 1939 fiscal year.

Age of systems. One hundred twenty-five of the questionnaires returned indicate the years the systems were established. The four oldest funds bear out a previous statement to the effect that police and firemen were the first public employees to inaugurate pension funds. One police fund dates back sixty years to 1880; another one was founded in 1887. The oldest firemen's fund was established in 1882; a second one in 1890.

Table IV shows the years the several types of funds and systems were founded by decades, commencing with 1880-89. Approximately 46 per cent of the systems considered in this survey were established during the years 1930 to 1939. This may indicate an increased interest in retirement systems for employees in the public service as a result of the publicity given to the federal Social Security Act and the fact that

TABLE IV

YEARS RETIREMENT SYSTEMS ESTABLISHED BY DECADES
1880 TO 1939

Employee group	1880 1889	1890 1899	1900 1909	1910 1919	1920 1929	1930 1939	Total
Teachers	0	2	3	13	4	12	34
Police and Fire	0	0	2	6	6	4	18
Police	2	0	5	1	5	4	17
Firemen	1	1	2	1	0	1	6
General	0	0	0	2	6	14	22
All	0	0	0	1	5	22	28
Total	3	3	12	24	26	57	125

these employees were not included in its provisions.

Another trend of interest is to be noted in the larger number of systems established for general and for all employees in the decade 1930 to 1939. No systems for these employee groups, according to this survey, were in existence prior to 1915. During the years 1930 to 1939 twenty-two systems were organized for all employees and fourteen were established for general employees. Later in this study the trend toward setting up funds on an actuarial reserve basis will be shown.

Number of members. The number of employee members were reported by one hundred twenty-three funds and systems. Membership ranges from a firemen's pension fund of thirty-eight active members to a state retirement system for general employees with 89,520 active members.

The difficulty in appraising and reconciling the administrative and management problems in systems with such a wide spread in the number of constituents is apparent. The firemen's pension fund with thirty-eight members is managed by the assistant fire chief of the municipality at an annual operating cost of approximately three hundred dollars. The amount of funds invested in 1939 was $24.000. The state system referred to had approximately $115,000,000 invested. There are one hundred thirty-nine employees on the director's staff and the annual operating expense is nearly $275,000.

Nine systems have less than one hundred active members. Thirty-four have less than two hundred, and fifty-eight, or 47 per cent of the total, have less than five hundred. Three state systems have, respectively, 60,000, 81,000, and 89,520 members.

A classification of the number of members by employee groups is shown in Table V. The summary of that classification is given here:

499 members or less	-	58	systems
500 to 999 members	-	11	"
1,000 to 4,999 "	-	21	"
5,000 to 9,999 "	-	11	"
10,000 to 19,999 "	-	12	"
20,000 to 49,999 "	-	7	"
50,000 and over "	-	3	"

The problem of efficient management in the smaller retirement systems can be more readily appreciated when a review of the secretariats of the fifty-eight funds with memberships of less than five hundred is made. Only six of the fifty-eight systems have full-time secretaries or managers. Thirty-two have part-time managers who have some other position within the governmental unit. Twenty systems have neither a full-time nor a part-time manager. The duties incident to the system are administered by some other official or by another department. In other words, these important duties are sandwiched in with the regular activities of the official, or of the department. That such an arrangement is not always accepted cheerfully is exemplified in the statement

TABLE V

SIZE OF MEMBERSHIP OF RETIREMENT SYSTEMS
BY EMPLOYEE GROUPS

	T	P-F	P	F	Gen.	All	Total
Less than 100	2	1	2	2	-	2	9
100 to 199	1	8	4	2	1	9	25
200 to 299	-	3	1	2	1	3	10
300 to 399	3	-	-	1	2	1	7
400 to 499	-	1	2	1	2	1	7
500 to 599	1	1	1	-	-	-	3
600 to 699	-	-	-	-	-	-	-
700 to 799	-	-	1	1	-	-	2
800 to 899	1	-	-	-	1	-	2
900 to 999	1	-	-	-	2	1	4
1,000 to 1,999	4	-	1	1	1	2	9
2,000 to 2,999	1	1	-	-	2	-	4
3,000 to 3,999	1	-	1	-	-	1	3
4,000 to 4,999	1	1	1	-	1	1	5
5,000 to 5,999	1	-	-	-	2	1	4
6,000 to 6,999	1	-	1	-	-	-	2
7,000 to 7,999	1	-	-	-	-	-	1
8,000 to 8,999	-	-	-	-	1	-	1
9,000 to 9,999	2	-	-	-	1	-	3
10,000 to 11,999	-	-	-	-	1	1	2
12,000 to 13,999	2	-	-	-	2	2	6
14,000 to 15,999	2	-	-	-	1	-	3
16,000 to 17,999	1	-	-	-	-	-	1
18,000 to 19,999	-	-	-	-	-	-	-
20,000 to 24,999	1	-	-	-	-	-	1
25,000 to 29,999	2	-	-	-	-	-	2
30,000 to 34,999	-	-	-	-	-	1	1
35,000 to 39,999	2	-	-	-	-	-	2
40,000 to 44,999	-	-	-	-	-	-	-
45,000 to 49,999	1	-	-	-	-	-	1
50,000 and over	1	-	-	-	2	-	3
							123

NOTE: Employee group symbols are as follows: T--teachers, P--Policemen, Gen.--General employees, P-F--Police and firemen, F--Firemen, All--All employees.

of one such official who answered the questionnaire and appended these remarks:

> I do not feel that the Accountant should be compelled by law to give her time, energy and efforts to this work without some remuneration. Because the Accountant does all of the work, is responsible by law for the work, has to supervise the books of the system, as well as attend to additional accounts in the municipal books, I think that she is entitled to some remuneration.
>
> If your board can have proper clerical assistance it might be a different proposition, but I have a girl just one afternoon a week, to post the deductions from the payrolls, and frankly I very much resent being compelled to add this tremendous amount of work to my duties, without being permitted to receive any remuneration.

Compulsory or optional membership. Those who have made thorough studies of pension funds and retirement systems are in agreement that membership for employees should be compulsory if the objectives of the retirement system are to be properly achieved. Sometimes the choice of membership is made optional for present employees when a system is newly established, and a stated time, perhaps a year, is set within which the old employees may join. Where membership is not compulsory, the employees who need the benefits most often do not take advantage of them, or they may resign and withdraw their previous contributions when a personal financial stringency occurs.

Of the one hundred twenty-two questionnaires that reported the information, only twelve show the requirement for membership to be optional. Three of these systems are less than five years old; five have been established more than twenty years. Four of the funds are for police and firemen, four are police funds, two include general employees, and one each is for teachers and all employees. Five of the funds are on an actuarial reserve basis.

III. CONTRIBUTIONS TO RETIREMENT FUNDS BY MEMBERS

Evolution of contributory plans. Contributory pension and retirement plans are those in which employees pay all or part of the cost of maintaining the fund. It has already been shown that the early systems required no contributions from employees, and the governmental unit undertook the necessary pension payments. The enabling legislation was predicated largely either upon forced action or upon sentiment, and the resultant pension payments had the appearance of charity.

Where formal pension plans were not in effect, the citizens of a community became familiar with the charity ball or benefit performance to pay the doctor's bills for a fireman or a policeman injured in line of duty. Such occasions continue to be a part of a citizen's responsibility in some municipalities. However, a gradual recognition of dual responsibility, for both the disability of employees and their retirement for age, has evolved until today the joint-contributory plan has become the most acceptable.

A retirement system operating on the joint-contributory basis offers a plan whereby the governmental unit joins with its employees in making adequate provision for old age and, in some cases, in securing protection in the event of death or disability.

Contributions by employees. What should be the employees' share of the costs of disability and retirement benefits? The simplest answer to this question would be to say half of the total cost should be borne by the members. Contributions of this size would be a recognition of the community of interest between the governmental unit and the employees in the retirement system. Furthermore, such a contribution on the part of employees would be in line with current economic and social practices, and would get away from the older something-for-nothing idea.

How much do employees contribute? One hundred six of the systems operating on a joint-contributory basis furnished information relative to the source of funds during the 1939 fiscal year. From these data it was found that the average contribution by employees in all systems amounted to 32.5 per cent of the total. The range extended from a contribution of 5 per cent of the total amount in a pension fund for firemen to a teachers' retirement system in which the members' contributions amounted to 84 per cent of the total. These calculations did not take into account pension funds in which the governmental unit paid the entire cost, or those funds which operated from a 100 per cent contribution by the members.

In the firemen's fund referred to in the preceding paragraph the municipality paid out of general funds 75 per cent of its total contribution and included in the 1939 tax assessment a special levy to cover the remaining 20 per cent of its contribution. This pension fund is over twenty-five years old and may be an example of the difficulties encountered when the attempt is made to change the enabling legislation so as to make employees' contributions more justifiable in relation to the benefits received. In this fund the retirement benefit allowed is one-half of salary at retirement date, and for the fiscal year 1939 the annual benefits averaged $779.

The influence of early custom when the governmental unit paid all of the costs of retirement allowances is shown in average contributions of 14.1 per cent of the total by members of firemen funds during 1939. These funds show an average life of approximately thirty years. Of the three hundred ninety-five prevailing firemen's pension funds classified by the International Fire Fighters Association, forty operate without any contributions from the employee members.[4]

Police funds with an average life of twenty-seven years, received 16.2 per cent of their total revenue from members in 1939. The combination police-firemen funds have an average

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[4] "Prevailing Firemen's Pension Systems," <u>International Fire Fighter</u>, 23:16-26, May, 1940.

age of twenty years and the members contributed, in 1939, 23.3 per cent of the total revenue. All-employees systems, averaging eight years since their establishment, received contributions from members amounting to 33.1 per cent of the total. Members of teachers' retirement systems contributed 40.1 per cent of total contributions. These systems have an average age of eighteen years. The highest average contribution for the period under discussion was made by the general employees' groups and amounted to 41.5 per cent. Nine years is the average number these latter systems have been in operation.

These facts would seem to substantiate a previous reference to a trend in retirement systems whereby the employee is assuming a more equitable share of the cost of retirement and other benefit allowances. Members of the older funds, police and firemen, pay the smallest share, while the newer systems for general and all-employees apparently established on sounder economic and social principles require employee contributions more closely approximating the fifty-fifty basis.[5]

A further breakdown in the sources of funds for retirement systems will be shown in Chapter IV, "Financial Management of Public Retirement Systems." Table VI gives the detail of

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[5] Lewis Meriam, <u>Principles Governing the Retirement of Public Employees</u> (New York, London: D. Appleton and Company, 1918), p. 57; see also Chapter IV for a discussion of the division of the costs of retirement systems between government and employees.

TABLE VI

PER CENT OF REVENUE CONTRIBUTED BY
EMPLOYEES FOR FISCAL YEAR 1939

(Figures under employee groups indicate age of system as of June, 1940)

Per cent of revenue contributed	Police	Firemen	Police and firemen	Teachers	General	All
5		30				
7	20	33	23,30			
8	37					
9	37					
10	35	32	5			
11	14					
12	60,16					
13	3,22	?		30		
15	32					
16			20			17
17		?, ?		31		
18			22			3, 2
19			19, 5			
20						18
21	18					
23				25, 7		
25			2,39	21	25	
26				13	14	
27				21	3	3
28					18	
29				29,23,31		16
30		6		3		6,15
31					5	
32				4,21		8, 3
33				26		
34	53				3, 3	
35			25		3	3
36			19	28	13, 3	3, 3
37				44,13	3	
38			20,20	19		3
40					25,20	3, 3
41				36, 4	2	
42						9
44			21			
45					?	
46	6			26		8
47				2,23		9
48				10	19	

TABLE VI (continued)

PER CENT OF REVENUE CONTRIBUTED BY
EMPLOYEES FOR FISCAL YEAR 1939

(Figures under employee groups indicate age of system as of June, 1940)

Per cent of revenue contributed	Police	Firemen	Police and firemen	Teachers	General	All
50				3	1, 2	25
53					18	
56					3	
60					7	
61					6	
69				2		
70				3		
82				3		
84				25		

NOTE: Question marks indicate that the age of the system is not known.

percentage of contributions by members in the several employee classifications with the number of years the individual systems have been in operation. The older ages of the police and firemen systems and the smaller percentage of contributions by their members should be noted and contrasted with the younger ages of the systems and the larger percentage of contributions by the members of the general and all-employee groups.

IV. BENEFIT ALLOWANCES RECEIVED BY RETIRED EMPLOYEES

Benefits the end result. The end result, candidly stated, for employee members of a pension system is the benefit allowance to be received if and when a certain contingency occurs. This is not to infer that the attitude of employees as a group is entirely selfish; on the other hand, there is no expentancy of altruism on the part of the employee toward the governmental unit which is the employer. It may well be that early public service pensions were based upon a reward for service over and above the wage; or that the pension or benefit was a charitable gesture by a benevolent public. Whatever the reason, there is ample evidence to substantiate the belief that the employees themselves were the instigating factor in the establishment of those pensions. If, as is to be hoped, a saner attitude toward a dual responsibility in the matter of ultimate benefit allowances for public employees is evolving, then social progress is being made.

This is no place to argue the relative merits relating to financial opportunities which may exist for the private employee or, for the public employee. Rather, it may be stated that through the efforts of those interested in public personnel much has been accomplished in recent years toward stabilizing and standardizing public employment, with the result that, generally, the employee in public service may expect more security in his job, if not equality in income, than the worker in industry and business.

If, then, a condition of public employment is membership in a properly organized and operated joint-contributory retirement system, the new employee should be the first to appreciate the protection which might otherwise not be his. Still, along with the older employee from whose interest the retirement system resulted, he will want to know "how much will I get?"

Types of benefits. The principal benefit allowance that results from the establishment of a pension fund or a retirement system is that for old age. The motives for instituting the old-age allowance are (1) to enable the government employer to retire from the force those employees who because of age cannot continue to do their work in a satisfactory manner, and (2) to relieve from the minds of employees fear for the future when they can no longer earn a wage.

A good deal of controversy has taken place as to the proper basis for earning this allowance. Some contend that a definite number of years of service is the criterion. Others insist that the attainment of a certain age is a more reasonable basis for the granting of a superannuation retirement benefit. The arguments are of value in determining what benefits are to be allowed in a given retirement system, but they are not to any great degree of particular interest in a study of administrative and management problems.

Other benefits that may be provided for in certain retirement systems are: (1) disability allowances, either through accident or disease, (2) allowances upon death, either in line of duty or from natural causes, or, after retirement, (3) withdrawal allowances upon leaving the job or retiring from the system; and (4) allowances to dependents in the case of death. The factors which may be considered for the inclusion of one or more of these in any retirement system are adequately covered in several studies on the general subject of retirement systems. They do not seem appropriate for further consideration here, except to say that the inclusion of any one or several of them tends to complicate the operation of the system, particularly if it has been devised on an actuarial basis.

<u>Methods of determining benefit allowances</u>. The determination of how much, or how little, to pay in retirement allowances is and probably has been since the earliest pensions a difficult problem. Three methods have generally been used in

American public pension systems. The flat or fixed sum, which in the first systems was doubtless just sufficient to prevent the beneficiary from becoming a charity case, is still used in many smaller and older established systems. The firemen's pension system[6] survey, previously referred to, lists forty-seven funds, 11.9 per cent of the total, which allow a fixed amount for pensions. These pensions ranged in monthly payments of from $45 to $120.

Another plan is to establish a benefit allowance on the basis of a percentage of the employee's salary. Under the first noncontributory pension funds this method apparently was the most natural. To pay an aged or disabled employee a definite part of his annual salary, usually half, seemed equitable and just. The half salary plan is still largely used. Seventy per cent, or two hundred seventy-three, of the three hundred ninety-five prevailing firemen's systems pay retirement benefits on the half salary basis.[7]

If the percentage of salary basis is used in establishing the retirement allowance to be paid, the determination of what salary scale to use is important. The last annual, or terminal, salary may be used, or the retirement benefit may be based on an average of the annual salary for a specified number

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[6] "Prevailing Firemen's Pension Systems," _op_. _cit_., pp. 16-26.

[7] _Loc_. _cit_.

of years, or the average salary throughout employment in the service.

A third plan not so much in effect in recent years was to provide pensions for employees on a discretionary basis; that is, the officials responsible for the granting of pensions were given the authority to decide who would be entitled to receive a pension and what the amount of the allowance would be. Obviously such a plan would offer opportunities for abuse and unfairness by the administrators and would fail to fulfill the objectives of a sound retirement system as they are presently understood.

Amounts of benefit allowances. Figures have been given from this survey to show the amounts which employees contribute toward the benefits they expect to receive. It will next be of interest to see what allowances are being received by the beneficiaries of the systems studied.

Two questions: "how many received benefits last year," and "how much was paid in benefits last year" were asked in the questionnaire which was used in this study. One hundred fourteen replies were received to both questions. No attempt was made to obtain a separate count of the number of beneficiaries in each system under the several types of benefits previously mentioned. Also, the replies gave the total amount paid in allowances without any breakdown into the amounts paid for each type of benefit.

The criticism may be made that the true status of payments for retirement, disability, and other allowances could not otherwise be shown. The data to be given, however, does indicate approximately the average benefits being paid in the system studied and, therefore, should be of some value as evidencing the allowances which former public service employees are receiving in benefits.

The average annual benefit allowance received by the beneficiaries of the one hundred fourteen systems that furnished the information amounted to $703.50 for the 1939 fiscal year. The largest annual average benefit allowance was paid to beneficiaries of the police-firemen systems. This amounted to $879. The police received $876, firemen $873, teachers $626, beneficiaries of general employee systems $616, and $570 was paid to the beneficiaries of all-employee systems.

The benefits paid in systems under the population groups are of interest. The largest annual allowances were paid by systems in cities of five hundred thousand or more population. The average for 1939 amounted to $863. Beneficiaries of the systems in cities under thirty thousand population received the smallest allowances, an average of $438 for the year. Systems in cities of from two hundred thousand to five hundred thousand population paid $638. Systems in cities of from one hundred thousand to two hundred thousand paid $648, and $805 was paid to the beneficiaries of the systems in cities having a population of from thirty thousand to one hundred thousand. Beneficiaries of the state systems received $641. These data are shown more clearly in Table VII.

V. SUMMARY

In this chapter the attempt has been made to summarize data showing the classification, the size, the age, and other pertinent information relative to the pension funds and retirement systems which were surveyed for the purpose of forming a background for the material to follow. Particular attention has been given to the contribution and the benefit phases of the systems. A retirement system is established for the purpose of providing future benefits for the members of the system. Benefit allowances cannot be paid without provision being made to have funds available at the proper time.

The collecting of funds and the payment of benefits are, therefore, the basic factors upon which the administration and management of retirement systems are predicated. These factors and those incident to them provide the subject matter for the discussion of administrative and management problems and practices in succeeding chapters.

TABLE VII

AVERAGE ANNUAL BENEFITS PAID, FISCAL YEAR 1939

(I) By employee groups		(II) By population groups
(I) Police and Firemen systems	(18)	$879.00
Police systems	(15)	876.60
Firemen systems	(8)	873.20
Teachers' systems	(31)	625.60
General Employees' systems	(20)	615.80
All-Employees' systems	(22)	570.20
(II) Cities over 500,000 population	(23)	863.50
Cities, 30,000 to 100,000	(28)	804.90
Cities, 100,000 to 200,000	(16)	647.70
Cities, 200,000 to 500,000	(16)	638.40
Cities, 10,000 to 30,000	(13)	438.10
State systems	(18)	640.60
Average of 114 systems		703.50

CHAPTER III

ADMINISTRATION OF PUBLIC RETIREMENT SYSTEMS

The general administration and the responsibility for the proper operation of a pension fund or a retirement system and for making effective the provisions of the statute or ordinance which establishes the system are usually vested in a board. This coincides with the traditional democratic practice of determining administrative policies through the process of discussion, deliberation, and popular action. The chief responsibility of most retirement boards is to make policy decisions and determine the general directions of the work. Their administrative problems may be said to be more technical than political.

This chapter is concerned with the functions and the effectiveness of retirement boards as determined through the survey that has been made. As in all public service organizations there will be found a considerable range in the degree of efficiency with which administrative tasks have been performed in the various pension funds and retirement systems.

I. GENERAL FUNCTIONS OF RETIREMENT BOARDS

Responsibility to the employees. The administrative board may be said to be the heart of the retirement system. Its general functions are the formulation of policies and the promulgation of rules of operation. But in addition, the board should be interested in balancing the respective interests of the employee, the governmental unit, and the public.

It is not enough to say that the board shall be responsible for collecting the employee's contribution and later, when the occasion arises, paying to him a benefit allowance. The process is not that simple. Membership in a retirement system means some sacrifice of present income by the employee in return for which he hopes to be relieved of anxiety for his financial security in later life. The human factor, with which the economic and social implications are involved, must be the concern of a retirement administrative board. And this concern cannot be dismissed through the mere passing of rules and regulations. There should be on the part of board members an appreciation of the economic and social factors affecting the lives of employees and a sympathetic interest in their problems. Employee representation on the board is important for an interpretation of the views of the members.

Responsibility to the government. The retirement board's responsibility to the governmental unit is primarily one of administering the system efficiently. This responsibility involves problems which are usual to any governmental activity. A knowledge on the part of the members of tax problems and governmental budget making is important because the board must usually look to the general fund or to a special tax levy for the employer's contribution to the system. In some localities political parties may have to be dealt with and the spoils system may have to be recognized. Because employees from many departments in the governmental unit may be members of the system, an understanding of the functions of all departments is essential to the maintenance of proper relations with those departments. The inclusion on the board of one or more officers of the government unit is customary and is helpful in coordinating the interests of the various government departments. Those generally are referred to as ex-officio members.

Responsibility to the public. An enlightened public opinion upon the conduct of governmental affairs is more and more becoming apparent; therefore, the retirement board has a responsibility to the public of fairly interpreting to it the program and activities of the retirement system. Adequate public appropriations do not come indefinitely without public sanction. Because of this, it is vitally important that a proper public sentiment in favor of the retirement system be created and maintained. Public representation is provided for on many retirement boards with the intent of securing public sponsorship and prestige. The value of any board member representative of the public is of course dependent upon who and what he is and his reasons for accepting the appointment.

Board weaknesses. Members of the board may exercise wide authority in the affairs of the retirement system, or the duties and powers of the board may be rigidly settled by ordinance or statute thus allowing less flexibility of procedure. There is the possibility that a board may become bureaucratic, especially in a large system. In other cases there may be an abuse of power, or a clique of members, particularly ex-officio members, may dominate the board's actions. Retirement boards are not essentially different from other public service boards and, therefore, are subject to the shortcomings in administration shared by all public service organizations. Even though there may be a degree of inefficiency in the performance of their administrative duties, board members on the whole must be credited with honest and fair motives.

II. SPECIFIC FUNCTIONS OF RETIREMENT BOARDS

Administration and management. It is customary to differentiate between the administration and the management of retirement systems by stating that the function of the board is to determine policies, promulgate rules and regulations of operation, and supervise the management of the system. This presupposes that the management of the system is turned over to a secretary or executive director. However, in smaller systems where a part-time secretary is used, or the management details are added to the duties of an employee in another department, the board members may find it necessary to combine actual management with their administrative functions. In fact, some systems reported in their questionnaire replies the chairman or other member of the board is the manager, usually an ex-officio member.

As previously stated, the enabling legislation which establishes a retirement system may be very general in its instructions with regard to administration. In these systems the board may exercise considerable control over the affairs of the system. If the statute or ordinance outlines in detail the administrative functions and operations, the board obviously have much less discretionary power. The more recently established retirement systems operate, fairly generally, under rather explicit and detailed legislative directions.

<u>Type of system affects administration</u>. The plan upon which a retirement system is based also contributes more or

less to the duties of the board. A noncontributory pension fund which pays only retirement allowances upon a stated condition of years of service or a retirement age does not offer many difficult factors in administration. A joint contributory retirement system operating on an actuarial reserve basis and providing a number of possible benefits, on the other hand, will require much in the way of technical as well as general administration.

In the latter type of retirement system the board must give consideration to problems and practices applicable to the collection, disbursement, and accountability of funds; the proper investment of funds subject to the limitations set forth in the act or statute; the adoption of mortality, disability, and service tables, under the guidance of an expert actuary; the maintenance of such data as shall be necessary for periodic actuarial valuations of the system; the review and approval of retirement, disability, and death claims; the engaging of medical, actuarial, legal, and investment services as necessary; the supervision of office management details and the duties of the secretary and his staff; and the rendering of reports of accountability and proceedings to the public and to the members of the system.

An example of how the duties and functions of a retirement system board may be succinctly yet clearly set forth in the enabling act or statute is given in Appendix IV.

Technical assistance to retirement board. Many of the procedures of management in a retirement system can be definitely established by rule or regulation. Carrying out these procedures becomes merely a matter of routine. Other phases of administration are not so easily disposed of. The management of funds and the investment of surplus money virtually demand expert knowledge to reasonably insure the safety of the principal sum and a return on the investment sufficient to meet the fixed interest rate. So many factors can influence the investment market that a watchful eye must continually be kept on the portfolio to take advantage of important market changes. The advice of an investment counselor may often make or save a great deal more than the fee he might charge. Yet many systems reported that the investment program was handled by the board or by a board committee, without outside professional advice. One secretary reported that the fund carried a large cash surplus because the board "hadn't gotten around to investing it."

The calculation of benefits and necessary income in an actuarial reserve basis retirement system is another phase of administration that demands specialized knowledge. The rates of contributions payable by the members and by the governmental unit and the benefits to be allowed are derived from an actuarial examination of the mortality, service, and compensation experience of the members of the system. If not required by law, the board should provide, at least every five years, for a similar investigation of the mortality, service, and compensation experience of the members and beneficiaries with a valuation of the assets and liabilities of the funds of the system. The information gained from these investigations and valuations makes possible any necessary rate changes to properly coordinate the promised benefits with the expected income. It is customary for a board to designate a professional actuary as a technical adviser to the board on matters regarding the operation of the fund. A few systems reported having a full-time member of the staff with actuarial experience.

In a system which offers disability benefit allowances it is important that provision be made for professional medical advice. Some systems make use of the department physician or of a physician in the employ of the governmental unit. Other systems reported accepting the diagnosis of the disabled employee's own physician as final. Such a practice leaves loopholes through which a dishonest employee with the collusion of his physician may defraud the system. The better-organized and managed systems favor a medical board of at least three members none of whom is eligible to participate in the retirement system. The medical board that is designated by the retirement board is given the responsibility of arranging for and passing upon all medical examinations required by the ordinance or statute. Upon completion of the necessary examinations and an investigation of essential statements and certificates by or on behalf of an employee applying for a disability allowance, the medical board reports its conclusions and recommendations to the retirement board for final action.

Legal advice is provided the retirement board usually by the attorney, solicitor, or counsel of the governmental unit in which the retirement system operates. Where there is no such official, the board may be given authority to appoint an attorney as legal adviser.

Lack of administrative technique. In the majority of retirement systems and pension funds the technique of administration apparently has not been very well developed. This may be due to two possible reasons: the relative smallness of most of the systems or the short time during which many systems have been in operation. The provisions of the legislation relating to the actuarial, personnel, and financial functions may not have presented a sufficient number of problems to require essential machinery to meet them. Or, it is possible that if this machinery does not exist, the details of administration are simply being inadequately handled.

III. THE USE OF ADMINISTRATIVE BOARDS

Extent or use of boards. Only one system of the number surveyed for this study, the New York State Employee's Retirement System, operates without the use of an administrative board. The state comptroller is the sole administrator of the New York system. The other systems operate under the administrative guidance of boards having from three to forty members.

A substantiation of a previous statement that pension funds and retirement systems have not followed any uniform procedure in the establishment of their administrative organizations is evidenced by the replies received concerning retirement boards. Boards differ materially in the number of members, the representation accorded the public, the governmental unit and the employee, the election or appointment of board members, the compensation paid and the terms of office, and the titles given to the administrative body. A review of the information secured about these matters is of interest.

Titles of administrative bodies. Twenty-five different titles for the administrative bodies are in use in the systems from which replies were received. The ones most generally preferred are board of trustees and retirement board. Thirty-four systems use the former while the latter term is the board designation in thirty-three systems.[1]

There appears to be no particular relationship in the use of these various titles in the matter of the age of the system, the type of employee covered, or the influence of geographical location. If there is any distinction to be noted, it doubtless will be found in the use by older systems of the term "pension" rather than the term "retirement." If a proper understanding is had of the essential difference in meanings of the two words, it would seem that retirement is to be preferred over pension unless the system is truly a pension fund.

IV. COMPOSITION OF RETIREMENT BOARDS

Number of board members. Here again there is no substantial agreement in pension funds and retirement systems as to the number of individuals that should comprise the membership of a retirement administrative board. Neither is there agreement with regard to the relative representation on the boards from the three groups interested in administration of the retirement system--the governmental unit, the employee, and the public.

A striking contrast in the use of boards is shown by

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[1] See Appendix V for a list of the titles with the number of systems using them.

the fact that one of the largest systems operates without an administrative board and a municipal system for firemen originally organized as a relief association in 1882 has a board of forty members, all of whom are employees elected by the members of the system. In the same city the police fund, established in 1902, is administered by a board of eight members. Three members of this board are city officials and the other five members are elected by the employees from their group.

Thirty-nine systems, approximately 30 per cent of the number replying, reported administrative boards of five members. Twenty-eight systems reported boards of seven members and twenty-eight reported boards of three members. This information from 74 per cent of the systems apparently indicates that an odd-numbered membership of three, five, or seven is preferable for retirement system administrative functioning. The extent to which boards of other sizes are being used is shown in Table VIII.

Representation on retirement boards. The proper allocation of members on any public service administrative board, in order that various interests will be represented and served, has always been a problem. Political parties, geographical areas, interest groups, and others clamor for recognition and often for control. While it may be true

TABLE VIII

SIZE OF RETIREMENT BOARDS AND
REPRESENTATION ON THE BOARDS

Number of members	Number of systems	Ex-officio members	Employee members	Public members
0	1	6	17	46
1	0	43	30	39
2	0	30	30	25
3	28	33	27	11
4	3	9	8	4
5	39	6	9	2
6	9	1	5	0
7	28	0	0	1
8	8	0	0	0
9	10	0	2	0
10	1	0	0	0
11	0	0	0	0
12	2	0	0	0
13	1	0	0	0
40	1	0	1	0
Not shown	0	2	1	2
Total	131	130	130	130

NOTE: To determine the number of systems having a given number of board members, read down in the column headed "Number of systems." For example, one system has no board members, twenty-eight systems have three board members, and so on.

To determine ex-officio board representation, read down in the column headed "Ex-officio members." Six boards have no ex-officio members, forty-three boards have one ex-officio member, et cetera.

that most public retirement systems are not directly branches of governmental units, their alliance is so close both in interest and in possible control that they may well be considered as such.

At any rate there are, as has been pointed out, three groups concerned in the administration of a public retirement system. Two of these groups, the governmental unit and the employees, are often placed in the position of vying with each other to the point of antagonism. It is possible that representatives of the governmental unit may lean too far in their attempts to control appropriations and benefit allowances unless these items are specifically set forth in the statute or ordinance, or are controlled by rule or regulation. The employees' representatives may, on the other hand, have too little regard for the fundamental interests of the retirement system in their efforts to gain as much as possible for their fellow members.

The public should be represented on the retirement board if for no other purpose than to act as a balancing factor between the representatives of the other two interests. Public representation, however, is too seldom provided for in the enabling legislation, probably because the proponents of the plan and the legislators thought only of the employer and the employee as being concerned in the affairs of the retirement system.

Basis of board representation. The weight of authority tends toward governmental control through representation on retirement boards as opposed to control by the employees. Two special reasons may be the basis for the tendency. One is that the presence of officers of the governmental unit on the board gives it a semblance of stability and continuity. The other is that the governmental unit usually has a larger stake in the money which has been contributed to the fund and therefore should maintain control.

The statements of two authorities are of such significance in this connection that they are quoted herewith:

> In view of the fact that the retirement system is established primarily for the advantage of the government, the public authority is entitled in all cases to maintain control of the funds and of the award of retirement allowances.[2]

> The representation in the board should be preferably equal between the two sides and be supplemented by a neutral member of high standing. But where the public moneys are involved to a far greater extent than the employee's contributions a slight preponderance to the employing side in the matter of representation may be advisable.[3]

That the employee members of a retirement system

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[2] Leonard D. White, Introduction to the Study of Public Administration (New York: The Macmillan Company, 1939), p. 412.

[3] Paul Studensky, "Pensions in Public Employment," National Municipal Review, 11:112-13, May, 1922.

should be represented on the administrative board is not only reasonable but proper. This principle is recognized in most systems. The substantial investment which employees have in a joint-contributory system gives reason for some representation on the governing body. Moreover, employee representatives can bring into the board deliberations points of view which might otherwise not be considered by the government representatives and the public board members, points of view which are vitally important to the employees. Furthermore, employees are certain to become more interested in the retirement system if through their fellows they have a vote in its administration.

British democratic practices have contributed much to administrative procedure in the United States. Fair representation of all interested parties on a governing body has been a factor in the success of British administrative processes, and the principle of representation by employees on the boards of management in public pension systems has long been recognized.[4]

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[4] "The experience of the British railway superannuation funds indicates that it is desirable to have the contributing members represented on the board of managers. The investigating committee suggested equal representation of the employees and the employers with a neutral arbitrator," Report of the Committee of the Board of Trade in Railway Superannuation Funds, British Parliamentary Papers, Vol. 57, p. 24; quoted by Lewis Meriam in Principles Governing the Retirement of Public Employees (New York, London: D. Appleton and Company, 1918), p. 342.

__Representation in present systems__. It is all very well to discuss the theoretical basis for representation on retirement system administrative boards, but a question of interest is how does representation work out in practice? The information secured from 131 replies should be fairly representative of pension fund and retirement system boards in general.

The data in Table VIII, page 72, show the relative distribution of representation for the three interested groups. It will be noted that government officials, ex-officio members, are included on all but six retirement boards. Employee members are included on all but seventeen boards, and representatives of the public are not included on forty-six boards. On a percentage basis these figures indicate that the governmental unit is represented on 95 per cent of the boards, employees are represented on 87 per cent, and the public has representation on 65 per cent.

Thirty per cent of the systems reported having administrative boards of five members. Boards of this size coincide with the thinking of several authorities who believe that the employer and the employees should have equal board representation and that a representative of the public should be included as a neutral balancing factor. If board representation ran true to this formula, a 40-40-20 per cent representation would result. A review of the thirty-five boards with five members which were reported shows the ratio of membership to be 48-34-18 per cent. The ex-officio members have the largest per cent of representation, the employees the next largest, and the public the smallest.

The seven member board representation as reported by twenty-eight systems, 21 per cent of the total, gives the employees the largest per cent of members, the ex-officio representation is next, and the public again has the smallest number. The percentage ratio is 40-35-25.

A more exacting review of the systems reporting board memberships of seven or five does not reveal any precedent that may have been followed in providing for boards of these numbers. Systems of the several employee groups, various ages, and location as to population were among those that reported. Apparently local and/or state practice in the matter of board membership was the deciding factor in establishing retirement boards of the sizes mentioned.

In considering the twenty-eight systems which reported having boards of three members, it is a simpler matter to determine the basis for having set up boards of this size. The majority of cities and towns reporting under this classification are in Massachusetts. Also, the Massachusetts systems were established to provide benefits for all employees of the city or town in conformity with a retirement act adopted by the state legislature. This enabling legislation provided for retirement boards of three members.[5]

It is apparent under the circumstances that a three member board is not a usual practice among retirement systems outside of the state of Massachusetts and therefore cannot be accepted as a criterion. What influence this phase of the Massachusetts legislation, enacted in 1936, will have on the future retirement system legislation of other states and municipalities will be interesting to watch. The percentage ratio of representation on the three member boards was as follows: ex-officio members, 38 per cent; employee members, 30 per cent; and public members, 32 per cent.

<u>Control of retirement boards</u>. If the total number of members on all boards of the systems which reported is used, it will be found that 40 per cent of them are employee members, 38 per cent are ex-officio members, and 22 per cent are

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[5] In any city, town, or county adopting the provisions of the acts there shall be established a retirement board, in cities and towns consisting of:

1. The city or town auditor or accountant, or officer charged with similar duties.
2. A person to be selected by the selectmen, or the mayor with approval of the aldermen.
3. A third person who must be a member of the system, and who is appointed in the same manner as the second.

Chapters 318 and 400 of the Acts of 1936, Commonwealth of Massachusetts.

representatives of the public. Left out of consideration in this computation were forty employee members of a relief association board upon which were no government or public representatives. Obviously this is an unusual board, and inclusion of the number in the total of employee members would have distorted the figures.

A clearer understanding of which group of representatives maintains control of the several retirement system boards may be gained by an inventory of board members according to voting strength. For this purpose it was assumed that the group with the largest number of representatives on a given board had control by virtue of their votes. What could not be determined was the probability of the combining of votes by the other two groups in any system in order to secure the balance of voting power. Situations of this nature can hardly be determined without personal investigation.

One humdred twenty-eight questionnaire replies gave sufficient information to make it possible to ascertain, under the assumption previously suggested, where the control of the retirement boards may lie.

Three possibilities were considered in the endeavor to decide if a board could be controlled. One of the three groups might have more votes than either of the other two, which should give it control of the board. Two groups might have the same number of votes, which would make it impossible to control the board without some combination of votes. All of the groups might have the same number of votes. Here again control of the board would not be possible without combining the votes of two of the groups.

Representatives of the employees had the vote control in thirty-seven boards, approximately 29 per cent of the total number. This group had vote control in 45 per cent of the police systems, 41 per cent of the teachers' systems, 29 per cent of the firemen systems, 27 per cent of the general employee systems, and 21 per cent of the all-employee systems. In the police and firemen systems employees controlled only 11 per cent of the boards.

Representatives of the government had the vote control in thirty-three boards, 26 per cent of the total. Board members representing the public had control in ten systems, 8 per cent of the total.

Twenty-eight systems, or 22 per cent of the total, reported that all three groups had the same number of board representatives. Most of these were all-employee systems. In fact, 50 per cent of all-employee retirement systems reported having equal representation on their boards for the three groups.

Control of the board was not possible in twenty systems, 15 per cent of the total, because the representatives of two of the groups had an equal number of votes and the third group had a smaller number of votes. This situation was most common in the police and firemen systems.

The respective voting strength of representatives of the government, the employees, and the public in the six types of systems is classified in Table IX.

Summary of board representation. Consideration must be given to the probability of errors in the figures which are taken from questionnaire replies such as have been used in this survey. The individuals who answered the questions may not, in some cases, have clearly understood what information was desired, or the answers given may not have been correctly interpreted. For example, one secretary reported a retirement board of five members all of whom were classified as representatives of the public. Upon referring to the retirement system ordinance of the municipality in question, it was found that the legislation provided for a board of five city officials. These in the opinion of the retirement system secretary who reported were representatives of the public, and doubtless they properly were, but not for purposes of this study.

The few possible mistakes in answers and in interpretation, however, should not seriously affect a fairly close

TABLE IX

SUMMARY OF POSSIBLE VOTE CONTROL IN RETIREMENT SYSTEM ADMINISTRATIVE BOARDS

Status of control	Types of systems						Total
	F	P	PF	T	Gen.	All	
Government members	3	5	6	8	5	6	33
Employee members	5	5	2	13	6	6	37
Public members	0	0	2	5	2	1	10
Equal representation	2	3	0	1	7	15	28
No vote control	0	4	8	5	2	1	20
Totals	10	17	18	32	22	29	128

NOTE: Abbreviations used at head of each column are as follows: F - Firemen, P - Police, PF - Police and Firemen, T - Teachers, Gen. - General, and All - All employees.

In reading the table it should be observed for instance that board members representing the governmental unit have possible vote control because of a larger representation in three firemen systems, six police systems, and so on.

approximation in the findings.

A summarization of retirement board memberships shows that government representatives have a voice in the affairs of 95 per cent of the systems reporting and they have possible vote control in 26 per cent of the boards. Representatives of the employees are included on 87 per cent of the boards and they have possible vote control in 29 per cent of the boards. The public is represented on 65 per cent of retirement system boards, and by their votes the public representatives may control 8 per cent of the boards.

In twenty-three systems where the enabling legislation allows for the representation of all three groups on the boards, and in addition makes it possible for one group to have a larger representation than either of the other two, the employees have probable control of sixteen boards, or 70 per cent of the total number. More than half of these are teachers' retirement systems. The public representatives have possible control in four systems and ex-officio board members may control three systems.

It has already been noted that, in the systems surveyed, 40 per cent of the total of all board members were employee representatives, 38 per cent were ex-officio members, and 22 per cent were public representatives.

Employee representatives seemingly have possible vote control in a larger number of retirement systems than either the government or the public representatives. The public has been given the least consideration in the matter of board representation.

Two tendencies are apparent. General and all-employee retirement system legislation has provided to a greater degree than has that of the other systems for board representation from all three of the groups. The majority of the more recently established retirement systems have made provision for public representation to a much larger extent than did the earlier systems.

From the data studied and presented it is evident that retirement systems in general have not followed authoritative opinion in the matter of board representation, that is, the governmental unit and the employees should have the same number of members on the board with public representation provided for as a balancing factor. Furthermore, where the government's share in the amount of the contributions is substantially greater, control possibly should lie in the government.[6]

V. SELECTION OF RETIREMENT BOARD MEMBERS

<u>Authority for retirement board membership</u>. The methods by means of which representatives of the respective groups are

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[6] Examples of legislative provisions for board representation are given in Appendix VI.

assured of membership on the various retirement system boards varies to a considerable degree. The entire board membership may be placed in office by the electorate of a given governmental unit through a regularly constituted election. This method is provided for in the legislation which established a municipal teachers' retirement system of some four hundred members and was an attempt to use a truly democratic means of choosing the members of the board, all of whom are public representatives.

The other extreme is illustrated in the police retirement system of one of the larger cities. Here three ex-officio members are assured of membership on the board by virtue of their city offices as provided for in the ordinance. These three elect the other five members of the board, who serve for a term of two years. Most certainly under such circumstances it would seem that the way has been opened to insure virtual control of the board by the ex-officio members.

In many retirement systems the legislation makes provision for board representation by two of the groups and further provides that these shall elect the representatives of the third group. Such a plan calls for some collaboration which may or may not lead to board control.

The method most commonly used in retirement systems where all three interests are represented on the board is to provide under the law that the government representatives shall be members because of their official capacity in the governmental unit, the representatives of the employees shall be elected by the retirement system members, and the public representatives shall be appointed by the executive head, or by the legislative body, of the governmental unit.[7]

Ex-officio board members. In the retirement systems which have governmental representation on the boards the legislation provides that in all but thirteen of the one hundred twenty-two systems the members shall hold membership because of their public offices. The ex-officio board members in five systems are appointed by the legislative body, the executive appoints them in three systems, the other members of the board elect the ex-officio members in two systems, the local board of education appoints the government's representative in one system, and the mayor appoints one and the selectmen elect the other in one system.

The finance officer of the governmental unit, whether he be treasurer, comptroller, or auditor, has membership on the boards of seventy-three systems.[8] This practice is in

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[7] See Appendix III for the methods by which retirement systems administrative board members are elected or appointed to that body.

[8] The following remarks by one retirement system secretary are quoted because they are illustrative of several similar statements: "I think that the Treasurer of every community should be a member of the Board ex-officio and entitled

accordance with the advice of authorities in the field of retirement systems, for example, "The board may consist of the chief finance officer of the municipality as ex-officio member and not more than six additional members."[9]

The mayor is an ex-officio member of the board in twenty-two municipal systems and members of the council, or similar legislative body, serve on eighteen boards. The head of the school system is a member on fifteen boards. These officials are predominant on public retirement system boards although many others, such as police chiefs, fire chiefs, and city managers, are board members in a few systems. Among others the insurance commissioner and the attorney general serve on the boards of some state systems.

Employee board members. Employee members of retirement boards who represent the members of the systems are for the most part elected by their constituents. This method is used in all but ten of the one hundred twelve systems reporting in this survey where there is provision for employee board members. In four systems the executive of the governmental unit

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8 (continued)
to a vote since the Treasurer is the Custodian of all municipal funds. To exclude him from the board is an oversight in my estimation. He should be compelled to be a member as much as the accountant for he surely must take care of the securities and the bank books."

9 Retirement Systems for Public Employees (Chicago: Municipal Finance Officers' Association, 1938), p. 5.

makes the appointments, the legislative body elects the employee representatives in three systems, the rest of the board elects the employee members in two systems, and in one system the local board of education makes the selection.

Public board members. The word public is somewhat of a misnomer in this connection because quite often it is possible that the person elected or appointed to the board is anything but a representative of the public in the intended meaning of the enabling legislation. Generally the act or ordinance, in systems where the government, the employees, and the public are to be represented on the board, will specify that such and such public official or officials shall be members of the board, and that the employee members of the system shall elect a representative, or representatives, from their body. The provision is made for a third member, or members, by some loosely worded statement as ". . . a person to be selected by the selectmen, or the mayor with the approval of the aldermen,"[10] or, ". . . a third member shall be chosen by the other two members."[11]

Much clearer and more specific are provisions for the

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[10] Contributing Retirement Systems, Chapters 318 and 400 of the Acts of 1936, Commonwealth of Massachusetts.

[11] Act providing retirement allowances for employees of the city of Worcester, Massachusetts, Chapter 410, 1923.

inclusion of public representatives on the board when stated thus, "Two citizens of the City of Baltimore who are not employees within the meaning of the Article . . . ,"[12] or, ". . . a citizen of the City who is not an employee of the City and who is not eligible to receive benefits under the Retirement System."[13]

Under a loosely worded provision the representative of the public, so called, might well be another city official or an employee. Whereas, when the wording of the provision conditions the eligibility of the representative, the member elected or appointed will more nearly approach being a representative of the community or the public at large.

A pattern may be found for the selecting of ex-officio members of retirement boards in the 89 per cent of the systems which provide for the automatic membership of certain officials. Also, the fact that in 90 per cent of the systems the employee board members are elected by the members of the system assures this as being the usual method. In the eighty-two boards having public members, however, it is not so easy to distinguish any definitely established precedent for their election or appointment.

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[12] Employees Retirement System, Ordinance 553 of 1926, City of Baltimore, Maryland.

[13] Retirement System, City Charter Chapter VI, Title IX, 1937, Detroit, Michigan.

The executive head of the governmental unit appoints the public board members in thirty-four systems, and the legislative body appoints or elects the public representative in twenty-one systems. The other members of the board in fourteen systems choose the public members, and the board of education makes the selection in seven systems.

The appointments by the mayors are usually subject to approval by the legislative body, and in these systems as well as in those where the legislative body makes the selection the intent of the legislative provisions was doubtless to insure neutral representation on the boards as between the government and the employees. Either of these two methods of providing for public representation is more closely in line with sound public policy than are the other methods referred to.

VI. TERMS, COMPENSATION, AND MEETINGS OF BOARD MEMBERS

Terms of office. The length of the term of office for members of retirement boards should be a matter of considerable importance to the welfare of the retirement system. The term may be so short that a new member may hardly learn what the board duties are when he must give way to another person. Obviously, the board member under such a plan can be of little value to the retirement system. In the opposite direction, the term may be so long that the members may develop a routine point of view which often results in a hidebound manner of action.[14]

This latter problem is also possible where ex-officio membership is provided by law and the governmental unit operates under civil service, or the local public official has a strong hold on his office. Under such circumstances the ex-officio member virtually has a life-long tenure on the board. The redeeming factor in such cases is that continuity in policies is attained. On the other hand, there is the likelihood of domination in board procedures by ex-officio members through their long familiarity with the problems of the retirement system.

Employee board members are usually subject to a definite term on the board. There is, however, a strong probability that once elected, and in the absence of a provision for change, the employee member may be reelected to the board time and time again because of his age, his popularity, his ability to control the election, or because no other employee wishes to run against him in the election.

Picture the possible plight of the board member who is appointed to represent the public. He comes on the board with

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[14] See Appendix III for classification of terms of office for retirement board members.

very little knowledge of the functions, problems, and procedures of the retirement system and must face the experience which years on the board have given to the ex-officio and employee members. It is quite possible that he may even be treated somewhat as an interloper. Unless by force of will or because of his standing in the community he can make his presence on the board felt, he probably will be permitted to contribute but little of a constructive nature to the deliberations of the board.

Length of terms. The larger number of systems surveyed for this study, 41 per cent, have provision for three-year terms for board members. Twenty-one per cent have two-year terms, 14 per cent have four-year terms, 12 per cent have one-year terms, 7 per cent have five-year terms, 4 per cent have six-year terms, and one all-employee system has provision for a seven-year term.

Approximately three fourths of the systems have board terms of three years or less. The provisions for terms of these lengths were doubtless made under the influence of the American prejudice against long tenures in office. Against this principle must be weighed the advantages to be gained in a term sufficiently long to permit a new member of the board to learn his job so as to be of some value to the retirement system before his term expires.

An authority on government stated the situation very clearly when he said ". . . a term long enough to plan and produce returns, yet not so long as to inspire a disregard of public sentiment, ... This may well be six years; it ought rarely, if ever, to be less than three."[15]

Certainly a term of one or even two years gives little opportunity for a newcomer to a board to be of effective service to the retirement system unless he is reelected or reappointed for an additional term.

Another consideration of some importance in retirement boards is the overlapping of terms so as to provide continuity in procedure. If local political interests are concerned in the operation of the retirement system, long overlapping terms may prevent partisan control of the board. On the negative side the long terms keep off the board that new blood which often is so essential to progressive action.

Compensation for board members. The basic law of only seven retirement systems of those studied made provision for compensation to members of the board other than covering the expense of travel in state systems. Two systems pay an allowance of $25 per member other than to ex-officio members for

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[15] William Bennett Munro, The Government of American Cities (New York: The Macmillan Company, 1912), p. 255.

each monthly meeting. Four systems allow $10 per member for each monthly meeting, and one municipal system pays the public representatives $5 for each weekly board session. It is customary in state systems to allow traveling expenses for out-of-town board members.

Board meetings. Most of the retirement boards meet once a month. Seventy-seven boards, or 60 per cent of the total number, hold monthly sessions. The quarterly meetings and meetings "on call" are the next most usual times for board sessions. Five boards meet six times a year, four meet semi-monthly, and five boards meet weekly.

If the system is large and the board members are actively concerned with investments and the several types of benefit allowances, meetings of twice a month or weekly would seem necessary. If the system is small, or the routine procedures are well established, a monthly meeting should be sufficient. Meetings of less frequency than one each month would seem to indicate that the functioning of the board members is little more than perfunctory.

VII. EFFECTIVENESS OF RETIREMENT BOARDS

Is administration by board effective? In an attempt to determine the relative effectiveness of the retirement system board, this question was asked in the questionnaire:

"Is there a more effective method of administration than by a board?"

The answers were varied and enlightening. Sixty-four of those who completed the replies to the questionnaires answered with a "No." However, most of these qualified their answers by such statements as "I don't know of any," "It is doubtful," and "Not in my estimation." Eighteen of those answering merely placed a question mark in the space provided for the answer. Such a symbol might indicate that there was doubt in the mind of the person who filled out the questionnaire. Eleven answered "Yes" with qualifying statements similar to these: "Perhaps more effective but not representative"; "More effective, but board is only safe method"; "Possibly, but any other method might not be deemed advisable."

One secretary answered the question with "Pleased we have no boards." A follow-up of this answer by correspondence elicited the explanation that the system had been operating successfully for years under the direction of a single administrator. The administrator has few discretionary powers because the several forms of retirement are defined mathematically by law. Where the factors relative to any form of retirement are known, it is not a difficult matter to compute the amount of retirement allowance. It is not possible to increase or decrease the allowance until one or more of the factors are changed. In the opinion of the director who explained the reason for preferring the single administrator to administration by a board, the operating of a retirement system by a board invariably slows up the administrative processes.[16]

Somewhat of an answer was given to this assertion in a study of a state teachers' retirement system.[17] Among others the question had been raised as to the desirability of merging with the state employees' system. The committee answered that certain present advantages would be lost. One was that the present system operated democratically in that members of the system participated in its control through board representation. Where decisions were to be made, the teachers through their representatives had a voice in those decisions; while in the state system the control was by one individual who had the power to make all decisions. There was no implication of criticism of the present single administrator, but fear of the possibility of a change in administrators was expressed.

<u>Group administration versus individual administration</u>. The old controversy of expert executive efficiency and

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[16] State of New York Employees' Retirement System.

[17] <u>A Study of the New York State Teachers' Retirement System</u> (Albany: New York State Teachers' Association, 1939), p. 9.

centralization of responsibility versus administrative action by several and continuity of leadership is still alive. The trend in public service seems to be toward specialization, permanence, and professionalism in management. But, there still remain, possibly, certain advantages in group action in some governmental activities, and quasi-governmental activities such as retirement systems.

Group action is usually slower than individual action, and a lack of technical knowledge may hamper board members in their decisions. On the other hand, the expert may develop that biased point of view which often results from specialization, and an individual is more susceptible to pressure, political or personal, than is a group.

The major criticism by secretaries of retirement systems results from the interference by board members with the operating details of the system. If that happy point of division between formulation of policy and actual operating management can be found, the administrative board has an essential place in retirement systems administration. Different interests must be served, and different points of view may contribute to the deliberations of the body, if all groups are represented. Changes in policy and procedure will be made gradually, and a continuity of program will be maintained if proper provision has been made for overlapping terms.

A question may arise as to the value of public representatives on the retirement board. Usually they do not possess the technical knowledge of the ex-officio members or the personal interest of the employee representatives. They may have accepted membership because of selfish reasons or because of a desire to be of some public service. Their attendance at meetings may be dependent upon the exigencies of their vocation. Their actual contribution to the deliberations of the body may be small. However, through their membership the public, disinterested as it well may be, has representation, and this representation gives some public sponsorship and prestige to the program of the retirement system. Whether or not the public representative provides a balance between government and employee, as some authorities hope, is dependent upon the system, the individual, and the situation.

Statements by retirement system secretaries. This survey was undertaken with the idea of securing the actual experiences and practices of retirement systems. The thinking of retirement system secretaries and managers is essential to an attempted compilation of criteria and procedures. For these reasons there are quoted from time to time the statements of the men on the job.

The following are representative of many statements that were received relative to administrative boards:

Example 1. (Municipal general employee system; three board members; all interests represented):

> In order to reduce possible political pressure of interference retirements, investments, et cetera, are better handled by board, matters thereby receiving the experience and advice of several members thereof. The management should be centered in one person, however, who devotes his entire time, or whatever time may be necessary, to the operation of the system resulting in direct handling of operating details and avoiding overlapping of responsibility and conflict.

Example 2. (Municipal all-employee system; five board members; all interests represented):

> Boards are valuable for general policy determination, and the performance of quasi-legislative and judicial functions. Problems of administration should be delegated to an administrative officer.

Example 3. (Municipal police and fireman system; five board members, all ex-officio):

> We can honestly recommend that any system is more practical with a board composed by private citizens along with city officials not elected by the people. For example, a non-elective finance officer, a city attorney, two members of departments represented and three private citizens. One of them to act as manager, and the entire group to administer the system, make investments, hold hearings and make decisions in all cases. This type of board will be entirely non-political, the two city officials being the interpreters of finance and law, and the remainder of the board the actual administration.

VIII. CONCLUSIONS

The actual administration of the retirement system should be in charge of a board representative of the three groups interested in the operation of the fund--the government, the employee, and the public. This body should operate, ideally, in a policy determining capacity, that is, the distinction, if possible, should be made between the duties incident to administration and those of actual management.

Such a practice is possible in the larger systems where management can be vested in an executive director or secretary. However, in small systems the board must necessarily, because of the absence of a manager, assume managerial functions, sometimes to the point of performing managerial duties.

The legislative act or ordinance ought to contain detailed provisions relating to membership, terms and conditions of retirement, the amounts of retirement, disability, death and other allowances. These provisions at best, however, can provide but a pattern for action. Particularly is this true in the disability provisions of a retirement system. Each is an individual case, not susceptible to pattern, and involves considerable discretionary power. Technical knowledge is not enough at this point; there is, in addition, need for a sympathetic understanding of the employee's personal problem in order to prevent mistakes at a very serious time in the life of the disabled employee.

Providing a good retirement law is not enough. Those individuals charged with its enforcement may make it effective in accordance with its objectives, or they may, because of disapproval or a lack of appreciation of sound management policies, dissipate its effectiveness.

The size of the board may range from three members to not more than seven members. If direct executive action without the assistance of a manager or secretary is necessary, a small board is to be preferred. If the function of the board is primarily interpretation and policy determining, a larger board may be in order. An important consideration in the size of boards is that as the board gets larger, there is less opportunity for individual members to participate in the deliberations with a possible lessening in their feeling of responsibility. Generally speaking, a small board is most practical for most purposes.

If the best type of citizen participation is to be secured in retirement boards, the term of office must be commensurate with the responsibility involved. No adequate public-spirited individual will want to accept membership on a board where the tenure will not permit of a constructive contribution. The same may be said for responsible employee representatives. They, however, usually have better chances for reelection because of the nature of their constituents. Board members representing the government usually are not affected by stated terms of office, as their board tenure is dependent upon the holding of a given government position.

Public retirement systems are quite often affected by politics. To avoid or even prevent political control of the board's policies, it is well to provide for overlapping board terms. The overlapping terms should allow for a gradual change in board membership and, if possible, prevent any one administration from appointing more than half of the members.

If the retirement board is truly an administrative body, a board meeting weekly, semimonthly, or monthly may be necessary for the transaction of essential business. A longer period than a month between meetings would give the impression that the board was expected only to review and give acceptance to activities carried on by a staff or through board committees.

Generally speaking, remuneration for services is not necessary for the procurement of public-spirited citizens as board members, except in cases where travel expense is involved. Volunteer service has long been the practice on public service boards and only in recent years have some governmental units made provision for compensating public board members in return for a hoped-for larger assumption of responsibility by those individuals.

The difficulties of developing a pattern, except within very broad limits, for the establishing of retirement administrative boards should be obvious because of the range in size, the difference in operating problems and procedures, and the dissimilarity in organization of the several pension funds and retirement systems. It may be hoped that as a better understanding of the purposes and objectives of public retirement systems is developed, more adequate mechanics of operation will evolve, based on the experience of successful systems rather than upon the localized thinking of the interested parties.

In this connection it is appropriate to call attention to an action taken in 1939 by the members of the retirement boards of the various counties, cities, and towns of the state of Massachusetts to make possible an exchange of information for the benefit of all concerned. These retirement board members organized the Massachusetts Association of Contributory Retirement Boards, the purpose of which is to afford an opportunity for the presentation and discussion of retirement problems of common interest and the means of keeping the several boards informed of legislation and proposed legislation affecting the operation of retirement systems. Such a forum should prove invaluable in assisting in the solving of local problems and, in addition, should be instrumental in effecting uniform standards of operation and procedure among the retirement systems of the state. Moves of this nature will do much to further progressively the interests of retirement systems in general.

CHAPTER IV

FINANCIAL ADMINISTRATION OF PUBLIC RETIREMENT SYSTEMS

The fundamental purpose of a public pension fund or a retirement system is to aid in keeping employees satisfied as to their present employment in the security that when they are no longer able, because of old age or disability, to render their best service, adequate provision will be made for them. Two objectives are possible of attainment thereby: employee morale is elevated and staff efficiency is increased.

The governmental unit assumes a financial obligation for the maintenance of the retirement system in order that the best interests of the service for which it exists may be advanced. The employee, if the system is jointly contributory, makes certain financial sacrifices during his productive years for the protection that will be offered him or his family in later years.

Three very important operations are necessary if the system is to be properly maintained: funds with which to pay promised future benefits must be provided; those funds must be safeguarded; and the money must be disbursed discriminately. These are the essential problems incident to the financial management of a retirement system.

In this chapter a review will be made of the methods used by present systems in meeting these problems, in an effort to ascertain their possible effective application to sound management principles.

I. RESPONSIBILITY FOR FINANCIAL MANAGEMENT

The problems of financial management. There is probably no more important consideration in the administration of pension funds and retirement systems than that of providing efficient procedures to safeguard the funds of the system. Often appointees without any previous experience in the field of finance have been placed on retirement boards and given the responsibility of administering relatively large sums of money. Lack of proper knowledge, carelessness, and inefficient methods of administration can be instrumental in dissipating the funds of the systems. In some cases retirement funds are managed by public officials whose main duties fall in some other field of activity. Obviously, the retirement system receives second consideration and, therefore, possible ineffective management. Where the dual functions of fund managers are incompatible, they should not be countenanced.

When a governmental unit establishes a retirement system, a moral duty, if not a legal one, rests upon it to set up sound methods of financial management to the end that the interests of the public, the employees, and the governmental unit are properly protected.

Authority for and extent of financial management. The enabling legislation which establishes the pension fund or retirement system usually provides that the board shall assume responsibility for the administration of the money belonging to the fund. The legislative instructions relative to finances may be very brief and vague or they may be detailed and explicit. The tendency in the legislation of recently established systems and in those which have been reorganized is toward rather minute legislative provisions for administration. This is especially true in those systems that are based on actuarial computations and where several reserve funds are provided for, the proper maintenance of which is essential to future fiscal prognostications.

A legislative provision which simply states that the board shall have charge of and administer the fund in such manner as it shall deem most beneficial leaves a great deal of discretionary power to the board members. A provision of this nature, particularly if there is absent a further provision subjecting the acts of the board to the jurisdiction of a higher authority, opens the way for careless, inefficient, and, possibly, dishonest financial administration.

Much sounder are those legislative provisions which state that the board is to receive, hold, invest, and disburse moneys belonging to the system under such rules as it deems necessary or convenient, but subject to further legislative provisions and guidance. These further provisions may provide that the funds shall be held in the custody of the fiscal officer of the governmental unit, that disbursements are to be made over the signatures of two or more board members or public officials, that proper books are to be kept and a periodic audit made, that investments are to be made in accordance with specified regulations, and that all proceedings of the board shall be open to public inspection. In some states the retirement systems are subject to supervision by the state insurance department, and the investments of individual systems are made by the state department of finance or a state department having similar functions.

Noncontributory pension funds. The financial administration of a pension fund in which the governmental unit appropriates all of the money for benefit allowances is usually perfunctory. The board first determines who the beneficiaries are to be and the amounts of the benefits to be paid. It then calls upon the government for an annual appropriation to meet the payments or for the pensions to be paid direct. Under a noncontributory plan of this kind there is little need for elaborate administrative machinery. The very absence of this machinery may, however, contribute to a slackness in management which may be detrimental to the stable operation of the fund.

Fortunately there are comparatively few of this type of pension fund still in existence. Only two of the systems reporting for this survey operate on a basis where the governmental unit furnishes the entire amount needed for pension payments. Both of them are municipal pension funds for police and firemen. One has been established for twenty years and the other for twenty-six.

Another type of noncontributory system is that in which the employees furnish all of the funds necessary for the payment of benefit allowances. None of the systems that reported operates upon this basis.

One municipal police and firemen's retirement fund established in 1937, which has a present active membership of 115 employees, reported that the employees contributed the entire revenue for the fiscal year 1939. Reference to the ordinance showed that the employees' contributions were made through a 2 per cent monthly salary deduction, and that the city was to be responsible for any balance which might be needed, over and above the collections from employees, to meet the promised benefit allowances. The system is too young and the number of beneficiaries is too small to require any current appropriations by the municipality.

Joint contributory systems. Much to be preferred from social and economic points of view are those retirement systems in which the employees join with the governmental unit in making adequate provision for old age and in securing protection in the event of death or disability. Especially preferable are those systems in which the share of cost to employees and to the government is approximately equal.

There are two distinct plans of operating joint contributory systems with respect to the time when the money necessary to meet the obligations of the promised benefits shall be provided. The one is generally referred to as the cash disbursement plan and the other is the actuarial reserve plan. In cash disbursement systems no reserve fund, or at most an inadequate one, is established, and the present benefit allowances are paid from the contributions of the employees, and, if needed, the governmental unit will appropriate sufficient money to meet any deficit in benefit allowances. Under the actuarial reserve plan one or several funds are set up, and in addition to the contributions of the employees the governmental unit pays into the fund each year an amount which will be sufficient, with interest compounded, to cover its share of the cost of benefit allowances based on the service rendered that year.

Because of the fact that different types of the cash disbursement plan are operating in retirement systems, it may be well to refer to them as nonactuarial as distinguished from the actuarial plans. The factors of finance administration are somewhat different in the two plans; therefore it is appropriate to describe them rather extensively.

II. FINANCIAL ADMINISTRATION OF NONACTUARIAL SYSTEMS

Real costs in retirement systems. The reason so many pension funds and retirement systems are in financial difficulties at the present time is that at their inception the real cost of promised benefits was not recognized or was disregarded by those who were instrumental in organizing the systems.

During the first years a retirement system is in operation, the number of retirement allowance beneficiaries appears very small in comparison to the total number of employee members of the system. This fact often gives a false sense of security to those who are interested in the system as to actual and eventual pension payments. As the years pass additional employees become eligible for retirement allowances, while many of those previously granted benefits continue to live. The result is that the total amount of retirement payments rises steadily, in some cases rapidly, until after a period of years the annual disbursements assume substantial proportions which bear a noticeable relation to the payroll.

This being true, it should be apparent that the real cost of a pension fund or a retirement system begins at the time the possible future beneficiary renders the service upon which the benefit allowance is eventually paid, and not at the time the allowance is paid. The real annual cost is the sum which should be set aside each year as employee service is rendered to meet that year's share of the total sum to be paid the employee following his retirement.

The reason for the difficulties, if not the actual insolvency of many systems, may be traced to the failure to recognize where the real costs of a retirement system lie in relation to the time element. A substantial balance in the treasury of a retirement system is no proof of solvency. Too often boards are complacent in the face of possible financial trouble, because a surplus of revenue over disbursements for a given year means to them successful management. The information that is of importance to the expert is a statement of the present value of future liabilities and of the assets available to meet them. It may generally be said that no system will be actually solvent until a dollar of liability is offset by a dollar of asset.

How sound funds operate. When an employee accepts a job in a governmental unit within which a nonactuarial and contributory retirement system is in operation, it is immediately recognized that some day age will prevent him from doing efficient work. Regardless of the remoteness of this possibility, provision for it begins at once.[1] A stipulated amount is deducted from the employee's wage each day period and placed in a reserve fund. The governmental unit at the same time begins to contribute a stated amount toward that employee's retirement fund. When the retirement period is reached, the employee is entitled to a retirement allowance. This benefit continued until death.

Mortality tables show that out of every so many persons of a given age and average collective health, a certain number will live to a given retirement age. The tables further show that those who retire may reasonably be expected, on the average, to continue to live for a certain number of years.

In its simplest form, the procedure for determining the expected liability for future retirement allowances is to find the number of employees expected to retire. Multiply this number by the average number of years of life expectancy after retirement. The next step is to multiply this figure by the annual retirement allowance each retired employee is likely to receive. The final figure shows the sum total of probable payments to retired employees from their retirement date to their death.

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[1] It is understood that when a merit system is in effect the new employee may not be subject to the provisions of the retirement system until a probationary period of employment has been completed. Also, the above description leaves out of consideration the several benefit allowances which may be provided through a retirement system.

The fund to assure and protect the benefit allowances expected to be paid should be accumulated before the retirement periods begin. This reserve fund, including the income from interest earnings, should be sufficient to pay the yearly benefit allowances from and after retirement.

No actuary can determine how long any one person will live, but he can closely estimate the reserve fund needed to provide retirement allowances for the survivors among a given number of persons. The margin of error in actuarial calculations will diminish as the number of persons considered increases.

The reserve fund is built up by contributions usually from employees and the governmental unit. These contributions, with accrued interest, are to provide the amount necessary to meet all retirement benefit allowances.

Retirement allowances may not be the only benefits provided for in a retirement system. Employees may be entitled to withdraw their contributions upon leaving the public employment. There may be also disability benefits, benefits to dependents, death benefits, and so on. However, the probable cost of each benefit, based upon the experience of years, can be fairly accurately determined. Each additional benefit required additional reserve and, of course, larger contributions.

An awakening on the part of public officials and those interested in public service to the probable insolvency of numerous retirement systems or to the tremendous tax burden imposed by nonactuarial plans has made possible the establishment during recent years of a number of actuarially sound retirement systems.

Nonactuarial retirement systems. For purposes of this discussion the designation nonactuarial is given to these systems which operate on a joint-contributory cash disbursement basis. Two types of cash disbursement plans will be considered.

The one plan provides for employees to make regular contributions, usually through salary deductions of a fixed amount or a per cent of salary to the retirement fund. These contributions are accumulated in a fund which retirement allowances are paid when necessary. The governmental unit does not make any immediate contribution to the fund but stipulates that when the amount accumulated plus the contributions from employees is not sufficient to meet the retirement payments for a given year, it will make up the deficit.

Such a plan is unsound from the start. Retirements during the first few years the system is in operation probably will be few and the contributions from the employees will be sufficient or more than sufficient to pay the benefit allowances. As the years pass, more and more employees will become eligible for retirement and the governmental unit will need to provide funds each year to make up the deficit balance. The situation eventually occurs where, with the total annual contributions of employees remaining relatively the same, and the total retirement allowances increasing, the government is called upon to appropriate annually a larger and larger sum.

This type of plan is considered to be unfair because it requires future taxpayers to pay the cost of retirement allowances based on service rendered at the present time. Furthermore, the financial history of most funds of this type has proved the unsoundness of the plan.[2]

If the legislative body of the governmental unit continues to be sympathetic to the provisions of the retirement system, the annual appropriation will doubtless be made year after year regardless of its mounting cost to the taxpayers. On the other hand, those responsible may decide that the appropriation in a given year cannot be made because of the

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[2] The cost to municipalities in increased appropriations under a nonactuarial plan is illustrated by the figures for New York City. In 1928 the City appropriated for the police and the firemen funds $4,263,000. In 1933 the appropriation was $6,595,000. In 1938 the figure was $9,648,000, and in 1939 the appropriation amounted to $10,612,000. Cited by Henry J. Amy, "The Local Pension Problem of Municipalities in New York State," Citizens Budget Commission, Inc., November, 1939, p. 10.

need of reducing governmental expenditures, or it may, if legally possible, reduce the benefit allowances, or again, it may attempt to secure a higher rate of contribution from the employee. Under any consideration the situation has become difficult and is opposed to the best interests of the employee and government alike.

The other type of joint contributory nonactuarial retirement system differs from the first in that the governmental unit makes some contribution to the funds of the system from the start, rather than waiting until a deficit in the system's finances has occurred. The legislation usually provides that the employee shall contribute a small per cent of his salary and that the government shall likewise contribute an amount based upon a percentage of each employee's salary. In lieu of a direct appropriation by the governmental unit, provision may be made that the revenue from certain public operations, such as licenses, permits, fines, and others, shall be credited to the retirement system fund.

This procedure is an attempt to establish what at least for a few years appears to be a sound system. The weakness lies in the arbitrary fixing of fund revenues without recourse to actuarial estimates as to whether or not these revenues will be sufficient to provide indefinitely the benefit allowances which have been promised.

The situation is similar to that of an insurance company which would issue a policy for a definite amount, the premium upon which had been fixed arbitrarily. Insurance companies are not permitted to operate in so reckless a manner. Premium payments must be actuarially established so that the cost of policies which are sold will be covered. Reserves must be set aside to assure policy holders of the company's ability to fulfill its contract.[3]

The chief difference in the two types of cash disbursement retirement systems is the element of time. In the latter type the eventual day of reckoning is possibly postponed a few years longer by the appropriations, direct or indirect, which are made by the governmental unit. The weakness of both types lies in a failure to recognize or acknowledge the real costs of the promised benefits and the projection of the ultimate tax burden to future generations of taxpayers.[4]

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[3] Paul Studensky, "Pensions in Public Employment," National Municipal Review, 11:100, May, 1922.

[4] Typical of many retirement systems is the experience of the Firemen's Pension Fund of Racine, Wisconsin. Upon its establishment in 1908 the employees were required to contribute one per cent of salary and the city indirectly contributed to the fund through a 2 per cent tax on fire insurance premiums. This financing carried the load of retirement allowances for twenty-four years until 1932, when the city directly appropriated $1,337, 8 per cent of the total amount of pensions paid that year, to make up the deficit. In 1933 the city had to appropriate $11,377, 57 per cent of total benefits paid. To prevent a bad situation from getting worse, the law was changed in 1939 to require salary deductions of 3½ per cent. Report of City Comptroller, Racine, Wisconsin, May, 1940.

Deficits in retirement systems. The disregard of actuarially estimated contributions and appropriations and the failure to set up proper reserves have placed many systems in a situation of insolvency. Unfortunately, the insolvent condition may not be apparent on the surface. A bank or life insurance company must have a surplus. If the balance sheet shows a deficit, the authorities close the doors. This is not true with governments. They may continue to operate on a deficit basis. In fact, with certain public retirement systems the deficits are literally established by law.

When a system is established, a deficit is at once created because the normal annual premiums for past service have not been paid. The longer the average past service, the larger the deficit. Unfortunately, a tolerance toward deficits in government financing has made the public careless about the support of its retirement systems as well as the support of other government activities.

It has been assumed that a retirement system is sound if funds will be provided with which to pay current claims. However, the perpetuity of the fund is endangered if it is not supported on an actuarial basis. This is true because under the nonactuarial basis there is a danger that the deficits may pile up to such an extent that future taxpayers may not be able to carry the load.

The present deficit in any fund, if there is one, is the difference between the total liabilities and the total present assets. Included in the liability figure must be that amount with interest which would be on hand if the current annual cost for retirement allowances for every member of the system had been paid into the fund and properly applied during all past years of service. It is the failure to include these figures in the computations of any retirement system that creates the impression of solvency when actually the fund is insolvent.[5]

Finance management in nonactuarial system. There are few problems in managing the finances of a retirement system where the deficit in retirement allowances is made up through an annual appropriation by the governmental unit. The employees' contributions are usually deducted from salaries by the department or officer in charge of the payroll. The money so deducted may be transferred into the general account of the municipality or it may be set up in a special retirement system account. The benefit allowances are often paid by the finance officer or the governmental unit as employees' salaries are paid. Few records other than for collections and

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[5] It was estimated that the accrued liabilities of nonactuarial systems in New York City by July, 1940, would approximate $500,000,000. The accrued liabilities in 1933 in other cities were: Buffalo, $16,000,000; Syracuse, $4,500,000; Elmira, $600,000. In 1931 New Rochelle had liabilities of $1,180,000, and in Troy they were $1,136,000. None of these cities had reserves to offset the liabilities. Amy, op. cit., p. 7.

disbursements are needed. Inasmuch as few or no reserve funds are built up, there is seldom any money to invest. The administrative board has few functions beyond the certifying of retirement applications, and the secretary, if there is one, may be concerned primarily with simple bookkeeping activities.

In nonactuarial retirement systems where the attempt is being made to create a reserve fund, the problem of investments may possibly be faced. Other than this additional activity, the finance management problems are similar to those mentioned in the preceding paragraph. No complicated system of records to provide material for periodical actuarial examinations is required. Individual member accounts are not necessary, and the complete accounting records usual to actuarial systems are not needed.

Fifty-eight of the systems reporting for this survey are of the nonactuarial type. Thirty-four of these furnished data relative to their reserve funds. Fourteen systems had no reserve funds whatsoever and in all but one of these the municipality makes a direct appropriation to pay retirement allowances each year of more than 65 per cent of the total amount. Twenty of the thirty-four systems reported having reserve funds, but the reserves in all but seven systems were less than three times the amount of total benefits paid in 1939. No information was secured to show whether or not the reserve fund in any system was being drawn upon to help pay the benefit allowances. Furthermore, an individual study of these nonactuarial systems would doubtless bring out the fact that many were virtually insolvent.

Generally speaking, the functions and problems of financial administration in nonactuarial systems are not so complex as those in retirement systems which operate on an actuarial basis.

III. FINANCIAL ADMINISTRATION OF ACTUARIAL RETIREMENT SYSTEMS

Actuarial reserve basis for retirement systems. An accountant, particularly in industry, who is concerned with a retirement plan may look upon an employee as a piece of human equipment that sooner or later will need to be replaced. Under the provisions of the retirement plan, it is necessary, when this piece of human equipment is replaced, to care for it financially the remainder of its life. If this is to be properly done, accounting practice will demand that retirement allowance credits be set aside each year as they are earned and that reserve funds be accumulated for use when they are needed.

While many public retirement systems have made provision for the setting up of reserves with the idea of protecting the future retirement benefits of employees, experience has shown in too many cases that the reserves were established without properly calculating the total amount of liabilities involved. Another point of importance which has usually been overlooked is that public service units generally are not static. The number of employees in a given unit has increased so that the number of employees becoming eligible for retirement each year increases because of this past growth of the organization. The result is that the necessary annual expenditures for retirement allowances continually mount. The failure to recognize and provide for these factors upon the establishment of public retirement systems may be blamed for the unhappy situations to be found in many governmental units.

Only when the public, and some public service employees, became aware of the serious financial difficultire being encountered by public retirement systems was it recognized that the operation of a retirement system was not unlike that of an insurance business, because retirement allowances are nothing more or less than insurance annuities. This awakening of those unselfishly interested in retirement funds resulted in the development of actuarial systems.

Under the actuarial plan of operation reserve funds are established, usually through the contributions of the employees and the government, which with the income from interest compounded annually are expected to be sufficient to meet the needs of future retirement allowances. The cost of retirement allowances for each year of service are charged against the joint contributions in the year in which employee service is rendered, the amount of the contributions having been actuarially calculated on the basis of the best possible available data.

These actuarially computed figures for the joint contributions of the government and the employees do three things. They show the governmental unit the actual labor cost in present wages and in future retirement benefits. The employee knows just what he is receiving for his services. The public is enabled to determine what is going on, thus eliminating the fear of hidden pension liabilities with their possible burden to future taxpayers.[6]

Accrued liabilities. One of the most striking problems to be met in nonactuarial retirement systems is the accumulation of liabilities for past employee service for which adequate financial provision has not been made. Upon the establishment of a retirement system on an actuarial basis, these accrued liabilities for services rendered

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[6] Lewis Meriam, Public Personnel Problems (Washington, D. C.: The Brookings Institute, 1938), pp. 220-21.

in the past are customarily accepted as an obligation of the governmental unit.

In order to attain strict actuarial solvency at the inception of a retirement system, the governmental unit would need to appropriate to a reserve fund a sum of money equal to all accrued liabilities based on proper actuarial computations. This sum, usually of relatively large proportions if paid in one amount, might seriously affect the financial stability of the public treasury. The accepted practice has been for the government to spread the payment of the total amount over a period of years by appropriating equal annual installments for ten or more years. The annual appropriation for accrued liabilities is of course in addition to the appropriation for current service liabilities.

Retirement system reserve funds. If accepted accounting practice is followed, several reserve funds will be set up when the system is established. To these the contributions and interest earnings will be credited; from them the several benefit allowances will be paid.

The criticism may be made that actuarial retirement systems require the keeping of numerous and, in some respects, complicated records and accounts. The reserve funds which are necessary for the maintenance of essential data add to the complexity of record keeping, but they are essential to the effective operation of a system of the actuarial reserve type.

Accounting procedure may differ by locality both as to the number of reserve funds which are considered necessary and as to the titles given to them. Those briefly described here are used in many systems. The <u>annuity savings fund</u> is the fund in which the contributions of members are accumulated for the payment of their annuities at retirement. When a member retires, his contributions and the interest which has been credited to his account in the <u>annuity savings fund</u> are transferred to the <u>annuity reserve fund</u>. It is from this latter fund that his retirement annuity is paid. The contributions made by the governmental unit are accumulated in the <u>pension accumulation fund</u>. Two types of contribution are made to this fund by the government. One is the contribution for current employee service, sometimes termed the normal contribution. The other contribution is that for past employee service or the accrued liability contribution. From this <u>pension accumulation fund</u> are paid all pensions and other benefits to members with prior service credit, that is, those members who were employees at the time the retirement system was established. When a new entrant, a member who was not an employee at the time the system was established, retires, the reserve to his credit in the <u>pension accumulation fund</u> is transferred to the <u>pension reserve fund</u> and his pension is paid from the latter fund. A fifth fund is often set up termed the <u>expense fund</u>. To it is credited all money provided for the administrative expenses of the retirement system and from it are paid all expenses necessary in connection with the administration and operation of the system. Usually the government assumes the expense of administering the system.

In some retirement systems there will be found a more complete breakdown of reserve funds. For instance, separate retirement accumulation funds may be set up for new entrants and for old employees. A fund may be set up for the accumulation of contributions to provide disability benefits, another may be set up to provide for death benefits, and still another may be set up for withdrawal payments. Whatever actuarial and accounting procedure is used, the various funds must be thought of as existing only on the books of the system, because usually all money is kept in one account for investment or savings purposes.

The term annuity generally is used to specify the retirement allowance which the employee's total contributions plus earned interest will buy, as dintinguished from the retirement pension which the contributions of the government will provide. A total of the two will be the retirement benefit which the retired employee will receive.

Building up reserves. There are those who are critical of the procedure in actuarial retirement systems, which makes possible the building up of seemingly large reserve funds. Certain it is that dangers are involved in the practice. Unless adequate safeguards are established, there is danger of the funds being dissipated by political action or through unwise or careless investment.

One secretary suggests that the government's contribution should not be taken out of the tax base, but should be left "in the pot," and that the government should appropriate its share of the benefit costs on a when needed basis, assuming, however, that actuarial methods are used to keep a true record of the liabilities involved.

Some thought has been given to establishing public retirement systems on a contingent reserve basis. Such a plan calls for setting up equitable retirement allowances and providing for contributions from employees and the government until the reserve fund reaches an approved amount. After this figure has been reached, the annual contributions by the government need be only sufficient to maintain the reserve fund at the established figure. The contingent reserve should be large enough to carry the system through any emergency period of two or three years.

If it be considered wise not to collect currently the annual contribution of the government, certainly the reserve funds must be assumed and bookkeeping records kept on that basis. Actuaries must presuppose the existence of a real fund, for in no other way can real costs be determined and liabilities be known.

Whether actual reserve funds are maintained or simply set up on paper, the processes of accounting and record keeping are the same. These obviously complicate the management factor in contrast to those processes which are needed in nonactuarial systems.

The reserve funds which are built up in actuarial systems present to the administrative board the problem of proper investment and, as one secretary puts it, the temptation to squander. A study of the investment policies and experience of retirement system boards over a period of time would be both interesting and enlightening.

IV. ACTUARIAL EXAMINATIONS OF RETIREMENT SYSTEMS

Actuarial valuations determine cost and liabilities. Another important factor in the financial management of actuarial retirement systems is the periodic actuarial examination and valuation. These examinations are important because through them the real costs of the benefit allowances can be ascertained and from the real costs current contributions can be determined.

The contributions required to provide a group of employees with the several benefits that are included in a retirement system depends upon the number of members in the group who will remain in the system long enough to take advantage of the benefits and the number of years they will live to receive those benefits. If disability allowances are included, the liabilities of the system are determined by a measurement of the future rates of withdrawal, death, disability, and old-age retirement among the members of the system. At the inception of the system the actuary attempts to secure the necessary rate measurements on the basis of past employment records. If records of past experience are not available, the actuary will base his estimate on the service and mortality experience of similar groups of employees. Computations of the cost of providing the various benefits will be based on these data.

<u>Example of procedure in calculations</u>. For a given group of employees of the same age and with the same number of years of service, the retirement system has definite liabilities. The first is determined from the mortality tables for the probability of refunds at death before the retirement age is reached. There is another liability for refunds to those who leave the service before reaching the

retirement age. A third liability exists to provide for those members of the group who become disabled. The remaining members of the group will be eligible for retirement benefits the liability for which is computed by methods regularly used by actuaries.

With the total liabilities for this age and service group having been determined by means of actuarial processes, the amount which is needed year by year to meet the benefit and withdrawal obligations when they become due is calculated. Similar calculations for other groups according to age and service are made, and the total amount for the system consists of the total amounts of all these groups. The illustration has not taken into consideration the annual contribution of the government which is necessary for the accrued liabilities for past service.

The actuarially computed annual cost is the yearly contribution required for the retirement system fund for long future periods if the personnel distribution as to age and service continues as it was at the time of the actuarial examination.

<u>Necessity for periodic actuarial examinations</u>. As with all insurance calculations, the actuarial experience for any small group might differ from the expected. The personnel distribution with regard to age and service in

small groups often does not remain the same. The distribution gradually comes to differ from what it was at the inception of the retirement system or from any succeeding examination date. For this reason new actuarial examinations are necessary from time to time.

The enabling legislation for an actuarial retirement system should provide that once in every stated number of years an actuary shall make an investigation into the mortality, service, and compensation experience of the members and the beneficiaries of the system for the purpose of checking the mortality and service tables used in the operation of the system. It is vitally important that these tables reflect the actual experience of the members as accurately as possible, so that they will furnish a dependable basis on which to determine the necessary contributions and the allowable benefits. From the results of periodic examinations any changes which are found necessary can be made so as to keep the system on a permanently sound financial basis. In making his forecasts the actuary will also give consideration to economic, social, and legislative changes and trends.

Frequency of actuarial examinations. How frequently should actuarial valuations be made? This question cannot be answered specifically. The size of a system and the number of benefit provisions are of important consideration.

In small retirement systems the changes are not sufficiently numerous to provide information from which the rates could be changed frequently. On the other hand, the changes in large systems might provide sufficient data for annual examinations. Many of the larger systems retain a permanent consulting actuary, who is thus in a position to provide continual actuarial control. Those systems that have made provision only for retirement benefits do not need valuations so frequently as those in which several benefits, including withdrawal, are allowed.[7]

The Municipal Finance Officer's Association suggests that an actuarial valuation should be made every three years at the least and that a yearly examination is preferable. The employment of a competent consulting actuary throughout the existence of the system is also advised in order that its financial stability may be assured and maintained.[8]

Valuation provisions of present systems. Sixty-seven of the systems studied reported operating on an actuarial basis. Periodic actuarial examinations are provided for by law or by administrative board regulation as follows: annual

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[7] Lewis Meriam, Principles Governing the Retirement of Public Employees (New York, London: D. Appleton and Company, 1918), p. 355.

[8] Retirement Systems for Public Employees (Chicago: Municipal Finance Officers' Association, 1938), p. 5.

examinations, twenty-eight systems; two-year periods, two systems; three-year periods, seven systems; four-year periods, one system; five-year periods, twenty-two systems, and six-year periods, two systems. The replies of five systems did not state their actuarial examination periods.

It is of some significance to note that thirty-nine of the sixty-seven systems which are operating on an actuarial reserve basis were established in the ten-year period 1930-39. Fifty-four, or 80 per cent of the actuarial reserve systems, have been established or reorganized since 1920.

The need for adequate records. Proper records must be installed and maintained if periodic checks of the rates of separation of employees, the mortality of beneficiaries, and other significant data are required. It is from these records that any necessary financial adjustments will be made from time to time.

It is at this point that objections to the actuarial reserve system are made. The complete set of records that is needed to provide important information for the periodic actuarial examinations seem to the layman to be entirely too complicated for effective operation. The complaint is made that entirely too much time will be required by an already busy secretary or staff to keep the records up to date. Offsetting such a criticism are the factors of safety and proper control which the experience of actuarially sound systems has proved, even though at some increase in the expense of management.[9]

<u>The actuary's contribution to sound retirement systems</u>. A substantial number of the nonactuarial systems which were reported for this survey indicated that a reorganization on an actuarial basis was being effected or contemplated because of unfortunate experiences under nonactuarial plans.

The warnings of secretaries in present charge of some of the systems are appropriate. One suggested the importance of having the retirement plan laid out and installed by an experienced actuary. If this is done at the start, with proper periodic supervision, it was stated, the system would almost run itself. Another secretary complained that their difficulties resulted from a failure to engage a competent actuary at the inception of the system. A similar complaint was made by a third secretary.

A board chairman wrote that to appropriate funds to a system that had not been established under the direction of an actuary would be as foolish as spending money to build

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[9] A list of the essential records necessary to set up and operate a retirement system is given in a study of retirement systems for public employees published by the Municipal Finance Officer's Association. The list of the records and their description will be found in Appendix VII.

a house for which no plans had been prepared. And finally,

> The function of the actuary in the establishment and conduct of an old age annuity plan is analogous to that of the navigating officer of a ship. The latter sets the course for the ship, but only after the captain has designated the port of destination. If the captain selects the wrong port, no skill of the navigator can bring the ship to the right harbor.[10]

V. THE COLLECTION OF FUNDS

Importance of providing funds and properly disbursing them. The beginning and the ending functions relative to the operation of a pension fund or retirement system are the providing of funds for the promised benefits and the disbursing of these funds in a manner that will meet the objectives for which the system was established. This does not imply that the collecting and the disbursing of the funds of the system are the most important factors of management, but they most certainly are the framework around which the other factors may be organized.

Sources of funds. The income of a joint-contributory actuarial reserve system is derived from the amounts deducted weekly or monthly from the regular pay of members, from annual contributions by the governmental unit, and from the

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[10] Henry S. Pritchett, *A Comprehensive Plan of Insurance and Annuities for College Teachers* (New York: Carnegie Foundation for the Advancement of Teaching, Bulletin No. 9, 1916), p. 25.

income from invested funds. This plan is a long step from the early public pension funds in which the government provided all of the money with which the benefits were to be paid, or from the voluntary mutual welfare associations of employees that depended upon the benefit performances, the picnic, the dance, or other similar events to procure funds with which to pay benefits to disabled and worn-out employees.

In spite of the progress which has been made in the development of retirement systems, there are still some which depend for at least a part of the necessary revenue upon forms of entertainment, the sale of stolen and unclaimed property, animal and other municipal licenses, traffic and other fines, witness fees, donations, the proceeds from vending machines, and others of like nature.[11]

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[11] "The city shall appropriate a sum sufficient to meet deficiencies each year. Other sources of revenue are: (1) all fines imposed on members of Commissioner of Public Safety. (2) All rewards, fees, gifts and testimonials for special services rendered except those which members may be permitted to retain. (3) Lost or stolen property and money without lawful claimant and money from sale of unclaimed property remaining in possession of Commissioner of Public Safety for one year. (4) Money from special services of policemen at balls, parties, weddings, excursions or picnics. (5) All absence deductions. (6) Two per centum of City's portion of the excise money received by treasurer. (7) All fines collected for violation of traffic or highway laws." Quoted by Albert H. Hall in _A Summary of Actuarial Surveys of Seventy Local Police and Fire Pension Funds in New York State_ (Albany: New York State Conference of Mayors, Publication No. 34, 1935), p. 25.

Such methods of securing funds for the payment of benefits to public employees may have had, at one time, the sympathetic acquiescence of the average citizen, who felt it his duty to make some contribution to the welfare of unfortunate employees, or it may have been that he hardly dared refuse to contribute. To a public gradually becoming more enlightened as to the functions and practices of public administration, such methods for securing funds must appear out of place.

Certain of the methods used to procure funds are strictly in opposition to sound public policy. Where the method of securing a certain sum of money is dependent upon increased effort in line of duty on the part of public servants, that method is incompatible with high standards of public service. The appropriation of the fines received for the breaking of municipal ordinances and the proceeds from the sale of condemned property may be placed in this category.

The indefinite amounts received from sources of the nature of those mentioned are contrary to the policies of exact appropriations so necessary for actuarial efficiency. Furthermore, if the administrative body condones loose practices in the procurement of funds, there is no good reason to expect other than a loose management of those funds.

Revenue sources of present systems. A summary of the distribution of sources of funds for those systems which were examined for this study shows that seventy-five systems received direct appropriations from the general funds of the governmental unit. An average of the total appropriations to these systems indicates that 49 per cent of the total amount of money received comes from general funds. Thirty-five of the systems receive government contributions through special tax levies. The average of total funds received from this source amounts to 48 per cent. The members contribute to the funds of 106 systems. Their average contribution for all systems amounts to 32 per cent of the total amount. Interest on investments and savings provides an average of 13 per cent of the total receipts in eighty-seven systems. Other sources, which include one or several of the numerous miscellaneous sources previously mentioned, provide funds for thirty-four systems. The amounts received average 7 per cent of the entire income. In twenty-five systems the revenue from the sale of investments is included in the total of current receipts. The average amount received from this source for the twenty-five systems is 18 per cent of the total revenue.

A practice among a few retirement systems which should be mentioned, but not commended, is that of requiring beneficiaries to contribute to the fund a certain per cent of their benefit allowances. The practice is so foreign to the true objectives of public service retirement systems that it deserves no further comment.

The collection of employee's contributions. In only one of the 133 systems which were surveyed are the employee's contributions made through remittances by the members. All other systems follow the accepted procedure of collecting members' contributions through payroll deductions. The latter method is by far the simpler in that it entails no costly follow-up of dilatory members. All deductions are made at payroll periods before salaries are paid, and a voucher for the total amount of deductions is certified to the custodian of the funds of the retirement system.

The mechanics of deducting the contributions and certifying them to the proper authority vary according to local practice. If the system retains a full-time secretary, he may, as is done in forty-four systems, supervise the collection of the members' contributions. In smaller systems it is customary for the finance officer of the governmental unit to supervise or actually make the deductions.

The enabling legislation of the better-organized systems usually contains a section stating that each member shall be deemed to consent and agree to the deductions which are made. Further, each member is required to sign a receipt upon receiving his salary less the deduction as a full discharge of all claims for the service he has rendered during the payroll period. A few systems require members to sign an order authorizing the governmental unit to make the stated deductions from his salary.

Additional contributions by members. Some retirement systems have provisions that permit members to contribute amounts in excess of the normal contribution in order to provide an additional retirement annuity. Such contributions are credited to the employee's account, but they do not affect the requirement to make the regular contribution nor do they increase the amount of the retirement pension promised by the government.

Certifying the government's contribution. In actuarial reserve retirement systems it is customary for the administrative body of the system to prepare annually a statement of the total amount necessary to cover the government's contribution to the system for the ensuing fiscal year. This statement is prepared upon the basis of the actuarial determination and appraisal for the period. The amount needed is then certified by the board to the proper government official or body in accordance with local budget procedure.

A similar method may be followed in nonactuarial systems in line with local regulations except that the determination of the government's share is based on nonactuarial calculations according to whether the government is to appropriate a stated amount on a percentage basis or make up a deficiency.

When the appropriation in either type of systems has been made, the retirement fund is credited with the amount and the system's administrative board is notified. The funds then become subject to the board's management under the legislative regulations of the retirement system.

VI. THE DISBURSEMENT OF FUNDS

Responsibility for funds. The administrative boards are generally the trustees of all funds of retirement systems, but the custodian of those funds is usually the treasurer, or similar official, of the governmental unit. He accepts all monies to be credited to the fund and disburses them upon authorization of the board under regulations provided for in the enabling legislation or through board action. The custodian should be required to make periodic reports to the administrative body on the status of the retirement system's finances. In the majority of the systems the governmental treasurer is an ex-officio member of the board.

Where better accounting methods of control are in effect, more than one signature is required on vouchers authorizing the disbursement of funds. In some small systems the custodian makes routine disbursements without reference to the board. Systems having a well-organized secretariat often authorize the manager to sign the vouchers. The signatures of one or more board members on all vouchers are customary in most systems.

<u>Disbursements classified</u>. Three general classifications will cover the disbursements in most systems, the payment of benefit allowances and withdrawals, the payment of expenses, and the investment of money. Once a benefit allowance has been approved for a member of the system, the payment of that allowance becomes a routine matter except, perhaps, where follow-up medical examinations are necessary with disability beneficiaries. The payment of the expenses of the system also requires only routine authorization. The investment of the funds of a system is a most important function, which should require the best possible consideration by the board members if that function is within their sphere of activity. The discussion in the following chapter is devoted entirely to the subject of public retirement system investments.

A few retirement systems allow members the privilege of borrowing a portion of their contribution at a specified rate of interest. This privilege may be a justifiable extension of service to members, but it hardly seems compatible with the best interests of sound retirement system policy. Furthermore, the additional bookkeeping which this service requires complicates maintenance of records to an unwarranted degree.

The payment of benefit allowances. If the legislation which establishes a retirement system is exact in its provisions, the granting of retirement for service allowances by the administrative body is a perfunctory matter. If the legislation is loosely worded and leaves the decisions with regard to retirements entirely to the board, there is ample opportunity for abuse and for discrimination. As has already been stated, once a retirement for service benefit allowance has been approved by the board, the payment of that allowance is practically a payroll item. The board before approving retirement allowances must establish criteria as to allowable employment service in a given period, usually a year, that is, how much employment service in any year is equivalent to one year of service. Creditable service is the term commonly used to express this factor.

Disability benefits in those systems which have provision for them are much more of an administrative problem for retirement boards. Only general assumptions can be used in determining a board's policy in the handling of disability cases, because no two are alike and each one must be treated as an individual problem. The better-organized and controlled systems make use of medical boards of two or more physicians, usually three. These boards may bring into a case whatever specialized service is required to establish the fact of disability. In loosely operated systems there often are opportunities for granting disability allowances without adequate proof of disability. Experience has shown that advantage has been taken by beneficiaries in numerous cases through the acceptance of disability benefits while engaging in some gainful occupation.

The rules and regulations of retirement systems should provide for the annual reexamination of beneficiaries who have been retired for disability, in order to determine if the disability continues to exist; and the legislation of administrative regulations should provide measures by means of which equitable adjustments may be made in reemployment or benefit allowances if the disability is found to be no longer permanent.

The provisions for these and other benefits which may be allowed through a retirement system should be described in the enabling legislation or in the administrative regulations as precisely as is possible in order to prevent or at least minimize the opportunities for maladministration and injustice on the part of the retirement board.

<u>Protection against fraud</u>. Just as advantage may be taken of a retirement system through the improper granting of a benefit allowance by collusion between a dishonest employee and an unscrupulous administrative board, so can false statements or falsified records by an employee defraud the system. Wherever the human equation is involved, there is reason to expect errors will be made. Eternal vigilance must be exercised by the management to avoid errors that might result in some member or beneficiary receiving from the fund more or less than he would have been entitled to receive had the records been correct. Moreover, severe penalties should be imposed upon any member of the system who knowingly makes a false statement or who changes any record of the system in an attempt to gain an advantage. The legislation of many systems places such an action in the category of a misdemeanor subject to punishment under the laws of the state. Provision should be made for the equitable adjustment of payments where errors or changes have been innocently made.

VII. REQUIREMENTS FOR AND THE VALUE OF BENEFITS

The board's responsibility. It is at the point of actual consideration of an application for a benefit allowance that the administrative body must endeavor to combine an attitude of humaneness with the austerity of administration. It may be that the definite provisions for, especially, service retirement preclude other than simple administrative authorization of the allowance upon proper application. But an application for any of the several benefits which may be provided is made generally by an employee or his dependents because of a radical change in his or their lives. This is particularly true with applications for disability or death benefits. The beneficiary, or beneficiaries, often faces a change in his economic and social status. To help meet such a change in the personal circumstances of an individual there is need of sympathetic understanding on the part of those who make the final determination of the benefit to be allowed.

There have been numerous examples of an uncompromising assumption by boards that applicants for benefits are guilty of something or other and that their request for that which may be rightfully theirs can be gained only through a fight literally to prove their innocence.

There is doubtless good cause to assume that there are some, perhaps many, who do attempt to take advantage of retirement boards. Even so, the determination of applications requires a fairness in attitude as well as administrative acumen.

Provisions for benefits. The development of public retirement systems has not yet produced a uniformity in the use of terms, the requirements for benefit allowances, or in the value of benefits. The descriptions of benefit provisions which are given here are a composite of those used in a number of the better-organized actuarial systems.

Service retirement allowance. The most usual benefit is that for old-age retirement, sometimes referred to as retirement for service or, again, the superannuation benefit. Better practice assumes the retirement benefit to be provided for the betterment of the service rather than to be given as a reward for service which was the factor of consideration in earlier systems. Many systems, those for police and firemen in particular, permit retirement at full allowance after a stated number of years, often twenty years. Because of this provision, an employee may retire in the prime of life and be physically and mentally fit to accept and continue other employment for many years. The better provision is that of establishing a minimum age at which an employee may retire or be retired and a maximum or compulsory retirement age.

The retirement allowance may be based on a stated percentage of the final annual salary or upon the average annual salary for a period of years. In actuarial systems the retirement allowance consists of two parts, an annuity provided by the contributions of the employee and a pension provided by the governmental unit. These are usually approximately equal and are based upon actuarial calculations.

Disability retirement allowance. Two types of disability may be provided for in those systems which allow disability benefits, that which is due to ordinary causes and that which is due to an accident in the actual performance of duty. In cases of the first type a minimum number of years, perhaps five, of employment is necessary for eligibility. Here again the total allowance may be based upon a percentage of average final compensation multiplied by the number of years of creditable service. In actuarial systems the accumulated contributions of the employee are used to purchase an annuity, and the government provides a pension which when added to the annuity is sufficient to provide the total benefit allowance.

Upon the occurrence of disability due to causes resulting from an accident in the actual performance of duty an employee may be granted an allowance regardless of his age or length of service. In actuarial systems the employee's accumulated contributions are used to purchase an annuity, and the government provides an additional allowance of a stated rate of the average final compensation. The benefit allowance is usually larger than that provided for ordinary disabilities. If the employee is eligible for workmen's compensation that amount is customarily deducted from the allowance provided by the governmental unit.

The Municipal Finance Officers' Association advises that disability benefits, because they are particularly subject to abuse, should not be paid unless the disability is total and permanent. Temporary disability, in its opinion, should be provided for through sick leave rules or through workmen's compensation.[12]

Death benefits. When an employee dies due to causes not the result of an accident in the actual performance of duty, the employee's accumulated contributions are usually paid to a designated beneficiary or to his estate. Some systems have a provision stipulating that a lump sum equal to a stated per cent of the average final compensation of the employee shall also be paid.

Upon the death of an employee resulting from an

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[12] Retirement Systems for Public Employees, op. cit., p. 4.

accident in the actual performance of duty, it is generally provided that the employee's accumulated contributions shall be paid to the surviving members of his family or to his estate. If the deceased employee is survived by a widow and/or children, an allowance of a lump sum or monthly payments for a period of time are paid. Regulations relative to stopping monthly allowance payments upon the remarriage of the widow, her death, or the attainment of a stated age by the surviving children are in order.

Discontinued service allowance. An employee who resigns or is dismissed from the public service generally has returned to him his accumulated contributions. In some systems when an employee, after a minimum number of years of service, is dismissed through no fault of his own, a discontinued service allowance is provided consisting of an annuity which is the actuarial equivalent of the member's accumulated contributions, plus a pension of stated amount or percentage of final salary.

Special privileges upon retirement. Optional privileges to be accepted by the employee upon retirement are often provided. The employee upon retirement may elect to receive the actuarial equivalent of his retirement allowance through reduced payments through life, with the proviso that, in case of death before his payments total the value of his allowance at the date of his retirement, the balance is to be paid to his heirs. Under another plan he may choose to accept reduced payments covering two lives, with the provision that at his death the surviving party shall receive throughout life one half of the original annual allowance.

The benefit provisions which have been described are not absolute, but they may be considered as exemplifying the functions and problems incident to the granting of benefits which must be faced by retirement boards. Benefits can be very costly to a retirement system, regardless of whether or not they are equitable, depending upon the manner in which they were established and the effectiveness of their administration.

Number of beneficiaries. The number of employees who receive the benefits allowed by a retirement system in relation to the number of active members is a most important consideration. This is especially true in nonactuarial systems and where the governmental unit is expected to make up any deficiency between revenue from contributions and disbursements for benefits. In actuarial systems, if the computations have been properly made and the system is efficiently administered, the ratio of active to retired members should offer no problem.

An example of the excessive cost to taxpayers in improperly established retirement systems may be seen in one municipal system for police. It has one hundred twenty-five members who contribute only 15 per cent of the total amount of revenue. There are fifty-eight beneficiaries and each received an average annual benefit amounting to $648 in 1939.

A point of interest which indicates how the ratio between beneficiaries and active members narrows as retirement systems grow older is shown in the following data. In forty-seven systems which have been established ten years or less there is an average of nineteen active members for each beneficiary. In fifty-seven systems which have been in operation over twenty years the ratio is a little less than nine actives for each beneficiary. Systems which were established forty or more years ago have less than five active members for each beneficiary.

The amount of benefit allowances. This study is not concerned with whether or not the average annual benefit amounting to $258 paid in 1939 to beneficiaries in a state system for general employees is sufficient; or whether the $1560 average allowance paid to teachers in another state system is too much; or whether the average annual benefit allowance in 1939 of $703.50 for all the retirement systems is either too large or too small. These are questions of economic and social interest.

The administration of retirement systems should concern itself with whether or not the amount of the benefit allowance is equitable in relation to the contribution which is made. If it is not, the government will pay a share of the benefit costs which is out of all proportion to the best interests of employee and employer.

A number of those who completed the questionnaires were quite emphatic in declaring that the benefits were too generous in relation to the amounts of employees' contributions. All these replies represent nonactuarial systems and implied that unless some revision was accomplished soon, the systems would become bankrupt and promised benefits would be lost.

VIII. AUDITING AND ACCOUNTING

The importance of proper accounting procedures. It is doubtful if there are in the field of public service any more important considerations than those of accounting and auditing. The importance of adequate accounting for government activities is even greater than in private business because of the public interest in all governmental affairs. The requirements of government accounting are often more intricate and involved than in private business. The necessity for a segregation of funds and for budgeting control exists in the very small government units the same as in the largest.

Governmental accounting has lagged behind that of business accounting in its development, and a failure to understand and recognize the essential requirements of adequate record keeping has often resulted in inaccurate and inadequate information. Incorrect information may result in erroneous actions on the part of public officials and legislative bodies. Business has of necessity changed its accounting methods in order to adapt itself to the rapidly increasing complexities of modern conditions. Many governmental units on the other hand are still conducting their record keeping through procedures which were suitable only to times of simpler and fewer problems.

Actuarial retirement systems, by the very nature of their involved procedures, demand technical skill in all ranges of responsibility from simple bookkeeping to positions of a supervisory character. After the system has been set up on the basis of recommendations by an actuary, the maintenance of the essential records is an accounting function.

It is the responsibility of the administrative board to direct that books of account and other accounting records necessary to the proper administration of the retirement system are set up and maintained. Such books and records should provide for day-to-day control, for furnishing data currently needed for administrative purposes, and for developing the information necessary for periodic reports.

It is important in actuarial systems that the assets and liabilities, income and disbursements of each of the several funds be kept separate from each of the other funds. All books and records should be prepared to allow for the accumulation of the data necessary for the statistical studies that are to be made from time to time and for the annual report.

A separate account should be kept for each member showing the amount of his contributions with the interest accumulations. The idea behind the keeping of each employee's contribution intact until retirement or withdrawal is that no part of his contribution to the retirement system will have been used to help pay the benefit allowance of any other employee. Also the plan virtually guarantees the creation of adequate reserves which are so necessary to the permanency and safety of the system.

The legislation which establishes a retirement systen should require the administrative board to publish an annual report showing the condition of the various funds, certifying to the accumulated cash and securities of the funds, and giving an account of the operation of the system.

<u>The importance of audits</u>. With the responsibility of trusteeship which is placed upon the administrative board, it is surprising how little attention is paid to the value of a periodic audit of all books, records, and accounts of a retirement system. The fault undoubtedly lies in the lack of public interest in governmental activities in general.

Eighty-four out of one hundred thirty systems reported that an audit was required by law. Forty-two systems are not legally required to have an audit of their records. Four systems reported that no audits were made. An audit each year is the usual practice, although audit periods of two, three, and five years were reported. Monthly, continuous, and occasional audits are used in some systems.

The audits in seventy-two systems were conducted by public officials, usually an officer of the governmental unit, or a representative of the department of insurance in those states in which that department supervises the operation of retirement systems. Thirty-two systems reported operating under the supervision of the state department of insurance. Board members do the auditing in three systems, and staff members handle the audits in three systems. The guess is ventured that in a large number of the systems where the auditing is done by public officers, staff, or board members, the supposed audit is hardly more than an examination of the financial condition and operation of the system.

Private firms of accountants conduct the audits in forty-seven systems at costs ranging from $25 to $2,500. This is in accordance with expert opinion that all books, records, and accounts of a retirement system should be audited at least once each year by independent accountants and preferably by accountants having some familiarity with retirement systems. While the expense of the audit must be given due consideration, the usual practice of obtaining auditors on a competitive basis at the lowest possible cost is to be decried.

Only by means of proper periodic audits can an administrative board intelligently report its trusteeship to the constituents of the retirement system.

CHAPTER V

INVESTING PUBLIC RETIREMENT SYSTEM FUNDS

The investment of the money is one of the most important problems in connection with any public retirement system. No matter how carefully the rates of contributions for the employees and for the government have been computed, a retirement system faces danger unless the money is wisely invested. Skill in investment management is important, first, because the accumulated earned interest is an essential factor in the building up of the reserves with which to pay the promised benefits; and second, because the safety and perpetuity of the system depend upon the soundness of the investments.

The mechanics and problems incident to investing the approximately two hundred and five millions of dollars in the reserve fund of a large state retirement system may differ from the mechanics and problems in the investment of the twelve thousand dollars belonging to a small municipal system, but the primary obligation to the administrative boards of both systems is the same, that is, absolute safety of investment with a reasonable return.

A lack of sound investment policy, inadequate investment machinery, and the failure to honestly accept its trusteeship are the principal reasons for the failure of retirement boards to conduct the financial operations of many systems with favorable results. A review of some of the investment administration policies and practices of public retirement systems will be given in this chapter.

I. THE GENERAL PROBLEM OF INVESTMENTS

Investment opportunities in large and small systems. The problems to be met in the safe investment of the monies of retirement systems are so varied and the experience of many systems has been so unfavorable, that a separate study of the field would be most appropriate. Unfortunately it has not been possible in this survey to learn the investment background of the several systems. The most that could be done was to accumulate information as to procedures, both good and bad, and from these, as well as from the statements of retirement system secretaries, evolve a few general observations.

It must be generally agreed that the safe investment of the money of a retirement system and, in actuarial systems, an adequate return on those investments are a prime requisite to successful financial management. At once, however, the problems of the small system as distinguished from those of the large system must be recognized.

The opportunities for the safe and profitable investment of funds are much less frequent for a small system. If the reserves that have been accumulated with which to fulfill the benefits that have been promised do not earn the anticipated rate of interest, the benefits will have to be curtailed or the revenue must be made up in some manner. In addition, the investment of the accumulated reserves must be such that there can be no question as to their reasonable safety.

The greater income from the contributions of many employees and the appropriations of the government which the large system enjoys make it possible to maintain a diversity of investments as to type, location, and maturity that is lacking in the small system. It is for these reasons that the large system is in a much better position to expect that a certain rate of interest, whether guaranteed or not, will be earned. As has been pointed out, this is an important factor, because it is the earned interest which builds up a large part of the fund that must be accumulated in actuarial systems to provide for retirement and other benefit allowances.

The factor of earned interest. Inasmuch as actuarial computations are based on the assumption that earnings on the investments will equal or exceed a given amount, usually 3 to 4 per cent, a number of systems in recent years have encountered unexpected difficulties. The years 1938 and 1939 were exceptional in that the interest return upon certain high grade bonds was the lowest in the history of the country. Many retirement systems are strictly limited in the obligations which may be purchased to federal and certain state bonds. With the especially low yield in federal bonds and with no immediate prospect of a fairly substantial rise, except through some unforseen circumstance, in the near future, some retirement systems must reorganize their procedures by lowering the assumed rate of interest and reducing the promised benefits, or increasing the amount of the contributions of employees and the government.

Restrictions on investments. There is a question how far the enabling legislation of a retirement system should go in restricting the field in which funds may be invested so that investments will be conservative, and for limiting the amount that may be placed in any one security so that the funds will be properly diversified. The general practice is to restrict by law the type of investments to securities that are recognized as being sound and then to give the retirement board the responsibility of investing and reinvesting the funds of the system with due regard to diversity, maturity dates, and earning ability.

Securities should be diversified as far as practical within the limits of the legal regulations. The maturity dates of obligations should be spread so as to avoid concentration of maturities at times which may not be favorable for reinvestment. The earnings of securities should closely approximate the interest that must be earned to meet the expectancy of acturial calculations. Each of these factors calls for an expertness not often, unfortunately, to be found within the personnel of retirement boards.

The need for proper investment supervision. Because of the number of variables involved, the supervision of investments cannot be termed an exact science. However, that supervision does demand some familiarity with the tools of the trade as well as the application of some effort and the exercise of common sense. Fortunate indeed is that retirement system which can include among its board members one or more who can meet these simple qualifications. Unfortunately, it is generally assumed that because a group of individuals can be induced to accept membership on a retirement board, whether for high-minded civic purposes or for purposes entirely selfish, that group is capable of administering the funds of a retirement system whether they be a few thousand dollars or many millions. The poor administration of the investments of many retirement systems may be attributed not to a lack of a desire on the part of board members to discharge their duties with a high degree of fidelity, but to a lack of knowledge concerning either the practical or the technical features of large investments.

It is possible that the funds of certain retirement systems have been dishonestly administered. Collusion between a broker and the board, or a board committee, to make frequent changes in the portfolio to increase commissions may be found. Brokers sometimes may be able to unload securities for which there is no other market and at prices out of all reason. Such situations as well as those in which mistakes have been made by boards with honest intent but through ignorance are indicative of the necessity for improved investment supervision procedures in public retirement systems.

II. RESTRICTING INVESTMENTS BY LAW

Restrictions as to type and amount. Should the law which establishes a retirement system restrict the field in which funds can be invested? The preponderance of opinion based upon the replies of one hundred nineteen systems answers this question in the affirmative. One hundred five replies indicated that the investment of the funds of the system is restricted by the enabling legislation. The replies of fourteen systems stated that no restrictions were placed on investments.

The reasoning back of such restrictions is obviously to protect the funds by having them invested in securities which are considered to be reasonably safe. The further restriction of limiting the amount of money that can be placed in any one obligation or type of obligation in order to secure proper diversification is not so generally recognized. A review of the laws of the several retirement systems shows that in comparatively few is any restriction indicated as to definite amount or percentage of total funds that may be invested in certain securities.

While these restrictions as to type of security and to the amount to be invested may tend to work a hardship on those systems which make use of the best possible investment advice, they do provide a partial control in those systems where the investment program guidance comes from board members who are not conversant, other than in a general way, with investment technique.[1] In the development of administrative criteria for public retirement systems, those regulations and procedures which will operate to the advantage of the average system should be recommended. For this reason the restrictions suggested seem appropriate.

__Extent of investment restrictions__. As in other matters relating to the administration of public retirement systems, the provisions in the several laws applying to the investment of funds range from those which are very explicit to those which are very general. Where retirement systems are restricted in the investment of funds to those legal for savings

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[1] "Investments are restricted by law to . . . government bonds, state bonds, and bonds of any incorporated city, village, or municipal corporation in the state, or tax warrants of the city of Chicago and of several other Municipal Bodies. . . . It might further be pointed out that although the restrictions on investments appear severe, those restrictions have resulted in the Fund having never lost one single dollar in its nineteen years of operation, and has not necessitated the employment of investment counsellors." Statement by Manager of a Municipal Retirement System in reply to the questionnaire used for this survey.

banks, or for insurance companies, or for trust funds within the state, the legal provision may be simply a statement to the effect that the board shall have power to invest and re-invest the funds subject to the limitations imposed by state law upon, for instance, life insurance companies.

A statement in the law that the board is empowered to invest surplus funds only in, for example, federal, state, or municipal bonds seemed sufficient to those who drafted the legislation for a number of retirement systems. The legal provisions for other systems require anywhere from a paragraph to a page or more of the enabling document.

Examples of a lack of that control which is so essential in the administration of public monies is to be found in provisions which merely state that the monies of the fund shall be invested in a manner authorized by the board. Such an inadequate provision is an open door for the dissipation of the retirement system's funds either through inefficient or dishonest administration by the board.[2]

Investment restrictions in effect. A summary of the types of securities to which retirement systems are restricted in their investments shows that forty-six may invest in federal obligations;twenty-four may invest in obligations of the

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[2] Examples of the range in legal provisions for the investment of the funds of retirement systems may be seen in Appendix VIII.

state, and counties, in which the system operates; twenty-six may invest in obligations of municipalities within the state. In the last situation an additional restriction in some cases limits investments to the bonds of municipalities above a certain class.

Eighteen systems may purchase bonds of any state and twenty-one systems may purchase bonds of any municipality, usually cities of the first class. One system is permitted to purchase railroad and public utility bonds. Thirty-five systems are restricted to investments legal for savings banks within the state. Nine systems are subject to the same legal restrictions as life insurance companies, and the restrictions placed on the investments of four systems are the same as those for trust funds under the state law.

Of interest is the fact that except in the systems operating under restrictions applicable to savings banks, insurance companies, and trust funds, with one other exception, the investments are limited to government obligations. Usually a retirement system is not limited to a specific type of government obligation but may diversify its holdings into a combination of federal, state, and municipal securities. The attempts of those who were instrumental in drawing up the legislative provisions of retirement systems to limit the investment of funds are shown in the resume of restrictions given in Table X.

TABLE X

CLASSIFICATION OF RESTRICTIONS ON INVESTMENTS FOR PUBLIC RETIREMENT SYSTEMS AS REPORTED FOR THIS SURVEY BY 105 SYSTEMS

Type	Number of systems
Investments permitted by law to savings banks	35
Investments permitted by law to insurance companies	9
Investments permitted by law for trust funds	4
Investments permitted by law for municipal corporations	2
Investments restricted to bonds of federal government, state, or municipal corporations within the state	21
Investments restricted to federal, state, and municipal obligations	18
Investments restricted to federal obligations	5
Investments restricted to local municipal bonds and notes	3
Investments restricted to state and municipal obligations	2
Investments restricted to federal, state, and corporations bonds	1
Investments restricted to Grade A bonds	1
Investments restricted to general tax obligations	1
Investments restricted to federal, state, municipal, railroad public utility bonds, and mortgages	1
Board has authority to invest without restriction	2

Systems with no investment restrictions. Of the fourteen systems which reported that no legal restrictions were placed upon the investment of funds, ten gave general classifications of the obligations which had been purchased. These follow closely the pattern of those systems which operate under investment restrictions with two exceptions. In addition to the purchase of governmental obligations, there are a few systems which invest in local real-estate mortages and, further, a few systems limit their commitments to local municipal and county obligations.[3] The systems which reported having no legal restrictions on investments are for the most part older systems, the average age being twenty-five years. Only three of the systems are organized on the actuarial reserve basis.

Suggested investment procedures. The administration of retirement funds, because of their quasi-public nature, demands the highest character of trusteeship. For this reason, investments doubtless should be confined to those securities which are reasonably conservative. Another reason

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[3] " . . . Almost all the money invested . . . has been invested in bonds, the proceeds of which are used to build new school buildings, roads and other improvements . . . many hundreds of men have thus been given employment. The Retirement System was, of course, not established for the purpose of providing funds for work relief, but when as a by-product it does provide $75,000,000 that was used largely for work relief during five years of service depression and unemployment it is rendering a public service of no mean proportions." Pennsylvania School Employees Retirement System, 1939 Report.

for this suggestion is that administrative boards generally do not have at hand facilities which permit of extensive investment inquiry and investigation. The limitation, therefore, would help to provide against unwise purchases.

Authoritative opinion advises limiting investments to federal and first-grade state and municipal obligations. Where the investments of a system are supervised by a state board of finance or similar body, a more extensive leeway may be permitted in planning the portfolio.

The practice of restricting investments to the obligations of the municipality within which the retirement system operates, or even to the obligations of the political subdivisions of a single state, may be questioned. The first consideration in the investment policy should be that the security proposed to be purchased must be sound. The second point to be considered is diversification as to geographical area to avoid possible difficulties from overloading the portfolio with obligations from one locality. And third, due regard should be given to investment diversification as to maturity dates. This is very important in actuarial reserve systems because of the cash requirements which are predicated on the calculations of the actuary.

The investment portfolio of a retirement system should not be treated as a trading account. Periodic valuations of the securities in the portfolio will bring to light investment weaknesses which should be remedied. Where the securities are of high quality and there is no reason to fear for their soundness, all things considered, frequent changes should not be made.

There have been cases, unfortunately, where the retirement system investment account has been a dumping ground for the unmarketable obligations of the municipality. Proper legal restrictions or a firm stand by the administrative board will avoid such occurrences. There are hazards to a degree in all types of investments thus requiring the utmost vigilance on the part of those charged with the responsibility of administering the funds to see to the safety of those funds. The foisting of weak municipal obligations upon a retirement system, thus lessening the safety of the principal sum and impairing the earning capacity of the funds, should be strongly condemned as detrimental to public interest.

In some systems practically worthless securities have been sold to the uninformed board members by unscrupulous salesmen, or securities have been purchased at prices above the market because of a lack of proper advice. The relatively small cost of securing the best available investment counsel would have been money well spent to avoid such experiences.

The safeguarding of funds. The members of a retirement system have every right to demand that their savings be given the utmost security. Likewise, the taxpayers should expect that the money appropriated to a retirement system from the public treasury shall be properly safeguarded.

The legal limitations on investments should be such as to insure high quality and proper diversification. If the question arises as to whether to sacrifice fundamental soundness in investments in order to maintain the necessary income, the decision should favor the holding of sound securities. The possible loss of income from earnings may be made up by some method or other.

Board members inexperienced in matters of investment should seek the assistance of the best available technical advice. Professional investment counselors may not be immediately available, but local bankers or others familiar with the field of investments may often be pressed into service. Subscribing to a full-time investment, research service can be of value, and periodic evaluations of the portfolio by some outside agency should be of great assistance.

Regardless of the nature of the legal limitations on the investments of the system, the administrative board should adopt a sound investment policy. Without such a policy the investment procedures are in danger of being haphazard. When with expert advice a policy has been determined, it should be entered into the records of the administrative board for the guidance of future boards. Strict compliance with the provisions of the policy should be adhered to and changes in the provisions should be made only when they are compatible with the best interests of the system.

III. THE FACTOR OF EARNED INTEREST

Assumed interest rates. The amount of interest that can be earned on invested funds is an important factor in the building up of reserves with which to pay the benefits allowed under the provisions of an actuarial reserve retirement system. A common practice has been to adopt a fixed rate of interest, and many systems, especially during the recent years of low yields on obligations, have been unable to get the rate that has been determined.

The failure to earn the assumed interest may prove troublesome to the administrative body especially if the legal provisions of the retirement system do not permit the board to change the rate of interest which is to be credited to contributors. Of sixty-two replies to the question "can the board change the rate of interest," thirty-four answered "no," and twenty-eight answered "yes."

More recently established systems provide that the board may change the assumed interest rate, or they provide that only the interest actually earned shall be credited to the accounts of members. Certainly it would appear that no higher rate of interest than can be earned with safety should be assumed, and that the experience of the funds invested over a period of years should be used as a basis for a modification of the interest factor from time to time.

Interest earned by systems. Eighty-seven systems reported having earned interest during the 1939 fiscal year as follows: twenty-six systems earned 3 per cent or less; forty-two systems earned between 3 and 4 per cent; and sixteen systems earned better than 4 per cent. One system reported earning 5 per cent interest in 1939, and 6 per cent was reported earned by two systems.

An average of the earnings of these systems would show apparently unwarranted earning capacity. In view of conditions of the past few years, however, it must be borne in mind that systems which earned no interest during 1939 were not included in the resume, and the replies to the questionnaire were made by systems which are, for the most part, doubtless above average in management control. Systems, the management of which, based on other surveys, has not been too good, failed to reply to the communication.

It may be concluded that the systems which reported earning high rates of interest have in their portfolios long-term investments the maturity of which will undoubtedly decrease the income from interest.

Interest earned in five-year period. Only fifty-nine systems reported figures for interest earnings during the five-year period immediately passed. From those it was found that 78 per cent of the systems earned better than an average of 3 per cent interest during the five years. Only 66 per cent of the systems reported earning better than 3 per cent for 1939.

Twenty-two per cent of the systems earned 3 per cent or less on the average for the five-year period in contrast to the 31 per cent which earned that amount in 1939.

These figures indicate the recognized tendency toward lower interest rates on securities available for the portfolios of the majority of retirement systems. A continuation of this tendency suggests the problem facing administrative boards that must compute retirement allowances and reserves on a fixed rate of assumed interest.

<u>Can the board change the assumed interest rate?</u> Out of fifty-one systems that operate with an assumed rate of interest, twenty-two, or 43 per cent, failed to earn a sufficient amount to meet creditable interest during 1939. Of this number, the boards of nine systems do not have authority to adjust the rate and therefore must have recourse to some method of raising the revenue necessary to meet the promised obligations.

Whether interest rates will continue to go lower or will go higher than at present is problematical. There are those who feel that interest earnings will not be so high in the future as they have been in past years and that retirement systems must adjust their provisions accordingly. The appropriations of the government may be raised, the employees may be asked to increase their contributions, or the contributions of both parties may be increased. A second method would be to decrease the amounts of allowable benefits. A third method entails a revision of the legislative provisions to reduce the rate of assumed interest to that which can be safely earned, with a resulting decrease in benefit allowances.

Whichever method is attempted, if past experience is any criterion, it will meet with opposition and boards will be faced with the task of educating employees to the economic and social soundness of accepting a necessary change as opposed to continuing a present program which is uncertain in its probabilities.

IV. INVESTMENT SUPERVISION AND ADVICE

Effective investment administration. The investment needs of a retirement system arise from the investing of reserve funds and the reinvesting of the funds from matured securities. The manner in which these investments are made will determine to a large extent the financial success or failure of the retirement system. Doubtless there are many cases in which, because of grave irregularities and abuses in the purchase and sale of securities, there has been a considerable waste of retirement system funds. Perhaps it is only fair to state, however, that in the majority of systems where there has been a dissipation of funds such dissipation may be charged to poor investment administration through carelessness and lack of knowledge rather than by outright corruptness.[4]

Employees, beneficiaries, and the public have a right to expect that those who accept the trusteeship of retirement system funds shall administer those funds in an honest and efficient manner. Altogether too often, however, the persons most directly interested fail to do their part in choosing those persons who can and will give honest and efficient management.

<u>Factors in mismanagement</u>. A closer investigation of retirement systems probably would show a mismanagement of funds owing to one or more of several reasons. Cash may have been allowed to remain idle when sound investment policy might have dictated its immediate investment. Evidence of an unjustifiable spread between the open market prices of securities and the prices charged to the retirement system

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[4] "The Massachusetts statute provides for a board to consist of the accountant, or if no accountant, the auditor ex-officio, a system member and a public member. The system member is elected by the system members for a three year term and the public member is also named for three years. Under such a set-up a board could easily come into being with no qualifications for safely investing the funds. The municipal Treasurer is the official custodian of the funds and also makes all disbursements, but, unless a member of the board, has no control of the investment of such funds." Statement by the manager of a small municipal retirement system in answer to the questionnaire used in this survey.

might be available. Such spreads could occur through misinformation by an unscrupulous dealer in securities or through collusion between board members and a salesman. Too large an amount of the system's money, when the safety factor of diversification is considered, may have been invested in one obligation or in one locality. A proper diversification of securities as to maturity dates may be lacking. This diversification is essential in order to insure the availability of adequate funds to meet benefit requirements. The sale and the reinvestment of the proceeds of obligations which have not matured may be justified if there is a reasonable lack of confidence in the security. Further, if a security has increased in value to the point where a substantial profit may be made and the proceeds can be profitably reinvested, the change may be in order. The sale of unmatured securities under any other circumstances should be viewed with suspicion as favoring some dealer. Situations might be found in which the funds of the retirement system had been used to purchase obligations of the governmental unit which could not be sold on the market. There may be cases where the funds have been diverted to sources inimicable to the best interests of the retirement system, or even illegally invested.

The responsibility of the board. These are only a few of the possibilities in investment procedure that may, through the wilfulness or carelessness of those responsible, operate to the detriment of retirement system resources. The responsibility for their proper trusteeship rests in the majority of systems with the administrative board. Ninety-two per cent of the one hundred twenty-one systems reporting on this phase of the survey replied that the administrative board authorized the investment of funds under legal provisions. Four per cent of the boards relayed the authorization of the investment of funds to a committee or to the secretary, subject, of course, to their jurisdiction. In five systems only was investment authorization placed in other hands. Generally then, the administrative boards have been charged with authority to invest retirement system money and must be credited or blamed for its management.

Where an investment committee of the board, or the secretary, is given the duty of investing the funds of the system, that duty preferably should extend only as far as investigation and advice in the matter of securities. The law usually provides that the board shall have the power, and its duty shall be to invest the moneys of the system. If the board for purposes of efficiency creates an investment committee, it is doubtful if such a committee should be given complete powers in the matter of investments. All recommendations of investment securities, whether by a committee, the secretary, or the advisor, should be referred to the board in session for final authorization. This is not to say that a subcommittee of the board composed of members whose qualifications may fit them for the task could not do an effective job. It might be vastly more effective. On the other hand, the board should have the final say if the customary legal provisions are followed.

Some systems relieve the board of any investment responsibility by placing it in other hands, such as the finance officer of the governmental unit or the state investment or other committee. With the proper experience and available technical advice this method doubtless is much more advantageous to the majority of systems. One authority in public administration suggests in this connection, "There is no fundamental reason why purely fiscal aspects of a retirement system could not be administered by the city Treasurer."[5]

<u>A possible procedure</u>. The intrinsic value of a government bond depends on the credit of the issuing governmental unit. The market price is determined by the additional factors of the rate of interest and the number of years to maturity. There is no yardstick for measuring the respective values of obligations absolutely, and the personal preferences of individual board members in the choice of securities may differ materially. However, if the legal provisions permit, every

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[5] John McDonald Pfiffner, <u>Municipal Administration</u> (New York: The Ronald Press Company, 1940), p. 147.

possible care ought to be exercised in the selection of securities to insure reasonable safety and diversification.

Preliminary and detail work incident to the study of offerings and the preparation of a schedule of these can be a time saver for the board as well as an insurance against the hit and miss authorization of purchases. If a managerial staff is available, these duties may be entrusted to it. If not, there should be good reason to authorize an investment committee to do the preliminary investigating. Through either of these methods a schedule of offerings in the market can be prepared and a copy given to each member of the board, preferably prior to the meeting, and the board as a whole can then pass on the purchases.

Here again the suggestion is made that the board can more effectively supervise the investment program of the system if it operates within a definite investment policy. Such a policy should allow for a balance among the several classes of securities permissible for investment, a reasonable diversification of obligations within each class, and a fairly uniform range of maturities. The objection may be made that such a widespread policy cannot be assumed by small retirement systems with limited sums of money to invest. If the available surplus is insufficient to allow for diversifications, then the board must exercise even greater care in its purchases in order that the safety of the funds may be reasonably guaranteed.

Professional investment advice. Only fifteen of one hundred systems reported that outside technical advice was used in the administration of investments. The state board of investments manages the portfolio in two systems. The state treasurer has that duty in one system, and twelve systems retain investment counselors regularly or occasionally for advice and recommendations. The managers of the system or members of the staff advise the boards in fourteen systems. A committee of the board assumes this function in six systems, and the board as a whole depends upon its own collective investment knowledge and experience in fifty-nine systems.

The prices which the several systems that retain professional investment counselors pay for their services is of interest. They range from an annual fee of one hundred dollars to a fee of eighty-five hundred. It is unfortunate that information is not at hand to show what investment advice is actually available to the respective boards. This is especially true because the data which have been collected indicate no uniformity whatsoever in the thinking of the several boards in the matter of professional investment counsel. The data which are given here relative to the costs of investment service, therefore, must be taken at their face value for purposes of comparison and not as indicative of actual circumstances. For instance, an apparently striking contrast in the attitudes of retirement boards in seeking investment advice is demonstrated by the replies of two systems which are given here.

One large state system operating under the administration of a board of six members with an investment portfolio amounting to, at cost, seventy-two million dollars, sold during the 1939 fiscal year securities valued at some fifteen million dollars and purchased during the same period some eighteen and one-half million dollars worth of securities. The board alone apparently advises on and supervises the investment of funds with the aid of two financial services which cost annually two hundred sixty dollars.

The other is a comparatively small municipal police and fire system administered by a board of five members. The book value of its investments at the end of the 1939 fiscal period was something over a half million dollars. During the fiscal year noted the system sold securities amounting to approximately fifty thousand dollars. It purchased securities of approximately one hundred ten thousand dollars. The board of this system relies on the advice of professional investment counselors for which it pays an annual fee of one thousand dollars.

The point of contrast in the examples cited is that the board of the first system transacted investment purchases and sales amounting to over thirty-three million dollars without, apparently, the advice of individual counsel, and at a cost of only $261 for investment services. The board of the second system although it bought and sold securities in the relatively small amount of one hundred sixty thousand dollars, evidently felt that the cost of one thousand dollars for investment advice was worth-while insurance.

Other contrasting examples are a system with twenty-one millions invested pays a fifteen-dollar annual subscription for a service, while a system with investments totaling two and one-half millions in 1939 paid $8,500 to an investment counselor; one system with eighty-eight millions in securities paid $4,000 for investment advice, and another with half that amount paid $900.

The use of outside professional counsel in the matter of the purchase and sale of securities is apparently not common practice in retirement systems. The attitude of local boards apparently dictates this usage. After all, the end result in the safeguarding of the funds of the retirement systems is the most important consideration regardless of the measures used to attain that result. This much can be said, however, the unfortunate investment experiences of numerous retirement systems would indicate that had technical and expert advice been procured in many cases, losses might have been lessened and at a very small percentage cost.

Where technical advice is not immediately at hand or is not favored, the very least a board can do is to occasionally invite a nonpartisan committee of whatever specialists are available to make a survey of the present investments and to make recommendations for an investment program which will help to establish and maintain the investments of the system on a sound basis.

Investment services and letters. The use of investment services and letters by public retirement systems is not any more general than the use of professional investment counsel. Thirteen out of sixty-four systems replied in the affirmative to the question "does the system subscribe to investment services"? The annual costs of the subscriptions ranged from ten dollars to three hundred dollars. The low prices given would indicate that several systems subscribe to business letters or general investment services that would be of insignificant assistance in the purchase and sale of obligations usually permitted to retirement systems. They might be of some assistance, however, to managers in their attempts to keep in touch with economic changes and trends in the security markets generally.

V. INVESTMENT EXPERIENCE OF RETIREMENT SYSTEMS

Cost and market value of securities. The attempt was made to secure information apropos of the investment experience of the several retirement systems by requesting answers to questions relating to the cost of securities and their present market value. The replies were too imcomplete to warrant any conclusions.

One hundred questionnaire replies gave the amounts of the funds invested at the close of the 1939 fiscal year, but the market value of the securities was shown in only nineteen instances. The figures from thirteen systems showed the market value to be greater than the cost. In six systems the market value was lower than the cost.

The failure to put down the market value figures of the remaining systems may be attributed either to an absence of records of the figures or to the fact that the figures indicated an adverse situation.

<u>To invest or hold accumulated funds</u>. The question of whether to permit cost to accumulate or to keep it invested is one that faces every investor at times. So it is with retirement systems, especially when the income from interest is important to the meeting of promised benefit allowances. To permit sums of money to remain idle for any length of time may seriously affect the reserves that have been actuarially calculated on a stated interest base.

Even the experts will not always agree on the question of whether to hold cash or to invest it at a given time. As a general rule, it may be said that the accumulated funds of retirement systems should be invested as promptly as possible commensurate with safety and with an adequate return, but the safety factor should at all times have prior consideration over that of earnings.

It should be understood that where the law fails to make provision, administrative regulations should prescribe that a certain amount of cash be kept on hand with which to meet current commitments in order not to disturb the invested funds.

<u>The availability of funds for investment</u>. If, then, it is sound policy to keep the surplus money invested, the administrative board will be derelict in its trusteeship if it permits that money to remain idle, and the resultant complaints by members against the loss of expected interest may be justifiable.

The periods of time during which funds are allowed to accumulate before being invested vary according to the amounts of money available for investment and the practices adopted by the boards of the various systems.

The investment times for funds specified by the greater number of systems was described by the terms, "continually," "constantly," "when available," and "when accumulated." These descriptions applied both to systems where the accumulations were sufficient for the board to consider and approve investments at weekly meetings and to small systems in which even the entire annual accumulations were hardly large enough to permit of adequate investment.

The second most accepted investment time is monthly. In these systems the boards apparently give consideration to the purchase of securities at the regular monthly meetings. The monthly accumulations from employee contributions in all but two of these systems were fairly substantial amounts.

The yearly investment period is used by a number of systems in which the annual appropriation by the governmental unit plus the annual accumulation of employee contributions is not a large sum. Unless during the year there was occasion to sell some of the obligations held and reinvest the proceeds, there would be little reason to make purchases because of the small amount of money available.

In a few municipalities in which the taxes are collected twice each year, the annual appropriation by the government is transferred to the retirement system's account in two instalments. Because of this policy a few boards have money available for investment at semiannual periods. These again, for the most part, are smaller systems and the employees' accumulated contributions by themselves do not warrant reasonable investment.

Two systems reported having funds available for investment each week. In another system the accumulated funds are invested "at the discretion of the board." A third reply indicated that investments were considered at the quarterly meeting of the board, and in a fourth system investments were made when the accumulated funds reached the one hundred thousand dollar mark or over.

It is not possible to develop any criterion in the time element for investing retirement system funds that would apply to both large and small systems. Circumstances vary as to the availability of surplus money by virtue of the amounts of the employees' contributions at payroll periods, the size of the appropriations by the governmental units, and the times at which the systems are credited with those appropriations. The general rule may be suggested, however, that, all things considered, administrative boards should not allow uninvested cash to lie idle for any length of time if there is any reasonable possibility of it being safely invested.

VI. INVESTMENT POLICIES AND PROCEDURES

The need of sound provisions and procedures. A review of the investment experiences of many public retirement systems would indicate that legal provisions and administrative procedures have had a rather haphazard development. Some mention has previously been made with regard to the motivating factors in the establishment of early retirement systems which placed them at a disadvantage from the start. Only through unfortunate experiences have retirement systems, and comparatively few at that, evolved to the place where they are operating under carefully drawn legislative provisions and adequately sound administrative principles. These provisions and principles, if properly adhered to by administrative boards, will safeguard the contributions and the expected benefits of the members and, in addition, will insure to the taxpayers a dollar's worth of return for each dollar invested in retirement systems for public employees.

Too many systems continue to operate under horse-and-buggy methods of procedure and many are administered by individuals whose attitude toward governmental and quasi-governmental activities is one of _laissez faire_. The only hope for improvement rests in an intelligent and unselfish desire on the part of employee members and the public to protect their interests in retirement systems to the end that they will demand from those who administer the systems an adherence to the policies and practices that are proving successful. This is of especial importance in the safeguarding of the funds of retirement systems, because a realization of the objectives for which benefit allowances are established hinges upon the safety of those funds.

Legislative changes the starting point. The starting point in safeguarding accumulated funds lies in the enabling legislation and its provisions relating to investments. To change the existing legislation in weak retirement systems is not an easy task, because the several interests which would be affected, even if the change worked to their ultimate advantage, would be suspicious of the proposals. The road which retirement systems have traveled in an effort to reach a more stable condition has been paved with obstacles provided by selfish employees, or employees with a lack of understanding, who have been able to reach the ears of near-sighted legislators and administrators. This situation is one that oftener than not has been faced by those who have been interested in progressive civic action. The solution is to be found, usually, in the slow process of education. Where possible, adequate permissive investment legislation based on the positive experiences of sound systems should be promulgated. Next, those controls which will tend to minimize the effects of careless and unethical administration should be established.

Some of the provisions and procedures in effect in the sounder systems and those suggested by experts in the field of public retirement systems will be discussed in the following paragraphs.

<u>Control of investments</u>. With comparatively few exceptions the supervision and control of retirement system investments rest with administrative boards. While the past recent years indicate a tendency toward placing investment control in the hands of those qualified by training and experience to do a reasonably efficient job, it is doubtful if the advantages of specialization will soon entirely overcome the traditional American desire for democratic administration.

The program to be attempted, therefore, is one of surrounding administrative boards with facilities and controls that will insure the best possible investment supervision under the circumstances.

Legislative provisions. The law which a retirement system operates should state in definite terms the types of obligations permissible for the investing of surplus funds. Many authorities are of the opinion that because of the quasi-public character of retirement systems the investments should be limited to federal, state, and municipal bonds.

In order to protect the funds, the investment provisions should state minimum or maximum amounts which may be placed in the several classes of permissible securities as to both types and localities.[6] Actuarial reserve systems should provide for diversification of securities as to maturity dates to enable the requirements of actuarial schedules to be met.

For effective control there should be a provision requiring a review of the investment portfolio by outside disinterested parties at least once each year. This review would be similar in its control possibilities to the annual audit of retirement system accounts.

The provision relating to the assumption of interest in actuarial systems should be flexible. Many systems are

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[6] See Appendix VIII for example. Teacher's Retirement System, Duluth, Minnesota.

operating under a fixed rate of interest which was predicated upon the higher earnings available a few years ago. In some systems the governmental unit guarantees the interest and therefore must make up the difference between that which is earned and that which is guaranteed. The interest rate promised should be that rate that can be safely earned, and the law should permit the board to make adjustments in the assumed interest rate if a fixed rate has originally been adopted. The manner in which any deficit in earnings in actuarial systems shall be made up should be specified, as should the method by which any surplus shall be distributed.

Outside investment advice. From the data secured for this study, it was not possible to ascertain what facilities were available, or used, for impartial investment advice. Only a few systems indicated that professional investment counselors were relied upon for advice or for supervision of the portfolio. There may be many systems in which the boards call upon local bankers, brokers, and other specialists. Their assistance and advice can be of value in relation to the degree of interest they may have in the range of securities available to the local retirement system. Where possible, administrative boards should use the available impartial service which local experts can render if professional counselors are not retained. In times such as these, if not always, when the security and money markets are so unpredictable, it doubtless would be good investment insurance to procure and pay for the best possible counsel. Working in conjunction with the board, the results of this counsel should be favorable and relatively cheap in ultimate cost.

Investment services and business indicators. The individual investor and institutional investment committees are continually urged to make use of sources of information and indicators that will be of value in establishing the necessary background for adequate appraisals of financial, political, social, and economic trends, so should those who are responsible for the administration of public funds, and perhaps to a greater degree because of the nature of their trusteeship.

Many business men who may be members of administrative boards have access to one or several services, letters, and journals. These media are also usually available to the finance officers of larger governmental units. Systems having managers upon whom the boards largely depend for essential information may well afford to subscribe to one or more of these sources of information at costs commensurate to the use that will be made of them. Lists of these aids and their relative value, as well as subscription prices, are readily attainable.

Investment committees. The appointment of a committee to act in an advisory capacity to the board in the matter of investments may be distinctly valuable in retirement systems which have large administrative bodies, and in which the surplus funds and invested reserves are of a substantial amount. A small committee, perhaps of three members, can be much more flexible in its deliberations than a large body, and also it can be called together more readily.

The general functions of the committee may be those of investigating securities and making specific suggestions to the board for purchases and sales. By virtue of the character of their duties, the committee would be in a position to make frequent reviews and valuations of the investment portfolio.

Members for the committee may all be drawn from the administrative board, they may be local citizens none of whom are board members, or the committee may be composed of board and nonboard members. Whatever plan of selection assures to the retirement system the best possible investment advice and supervision will be expedient.

Inasmuch as the legislation of most retirement systems provides that the boards shall administer the finances of the systems, it may be considered unsound administrative practice, in the absence of specific legislative provisions to the contrary, for committees to be vested with authority to complete investment transactions without first procuring the approval of the retirement board.

Facilities for safeguarding securities. Boards should provide facilities for the safekeeping of securities. These may be available in the vaults of the finance officer of the governmental unit. If not, space may be procured in a local bank; or a bank or other similar institution may be retained as custodian.

Custodianship by a reputable agency will reduce the responsibility of the person who otherwise would have charge of the securities. For relatively small fees the custodian will handle all of the details incident to registering bonds and collecting interest. Even if the services of a custodian are used, investment records should be kept by those in charge of the retirement system for checking purposes.

If the securities are kept in the facilities of the governmental unit or by the retirement system itself, every possible precaution should be taken for their safekeeping in every respect.

Keeping investment records. It is evident that those responsible for the management of many retirement systems do not appreciate the importance of maintaining proper investment records. Information desired for this study was not available because data relating to securities have not been kept in most systems and as a consequence could not be reported.

The most elementary of the essential investment records is a running inventory of the portfolio showing the title of each security, its interest rate, dates of interest payments, maturity date, and the cost. Sad, indeed, is the condition of the management in any system where sufficient time or effort cannot be given to do this simple recording. Preferably, an individual record should be set up and maintained for each obligation.

Any banker or broker should be able to give advice and suggestions as to the records that should be established and the information that should be recorded to make investment control effective and provide material for necessary follow-ups and reviews.

The investment policy. A most important adjunct to successful financial management is a policy of investment procedure. The policy should be outlined and entered in the proceedings of the administrative board. It should then be adhered to rigidly. If the legislative provisions relating to investments are exact, the policy may be largely a re-statement of facts. If, on the other hand, the legislative provisions are general in character, the investment policy should be detailed and exact. The lack of a definite plan of investment procedure is the root of most of the mistakes in investments.

The points to be covered in the investment policy are those already suggested for the legislative provisions. Among them should be included the types of securities that will be given consideration with due regard to diversification by type, area, and maturity dates. Reasonable limitations as to the amount that may be invested in one obligation or type of obligations should be stated. Trading in securities other than for the purpose of eliminating the poor ones should not be condoned. Attempting to guess the trend of the market is usually a dangerous practice for the inexpert. Authoritative opinion suggests taking the best rate obtainable in a present market. Safety of the security should be given prior consideration over rate of return. Only that amount of money which is needed for current commitments should be kept out of the investment fund.

Professional investment advice should be provided at least occasionally if not continuously. Subscribing to some form of investment service can be helpful in projecting the investment program. A periodic analysis and valuation of the security holdings by an outside agency are most effective as a method of control and as a check on the investment policy.

All of this may seem somewhat perfunctory to some, but the failure of administrative boards to follow a well-defined plan of supervision has been responsible for the careless and costly investment experiences of many systems.

Conclusion. One factor has been left out of consideration in the proposal of suggestions that may be of assistance in strengthening the investment programs of many retirement systems. The human equation must at all times be reckoned with in governmental and quasi-governmental activities. Carelessness, ignorance, selfishness, and dishonesty have traditionally been associated with all human affairs, and effective controls and procedures can do little more than act as deterrents to those influences. As administrative processes progressively develop, it may be hoped that the interest of able officials, retirement system members, and the public will increasingly insist upon the choice of upright and intelligent persons to administer those processes.

CHAPTER VI

MANAGEMENT PROBLEMS AND PRACTICES

The essential difference between administration and management in activities such as public retirement systems which operate under legislative provisions should be found in the policy determining functions of the administrative board as contrasted with the details incident to the development of those policies. In systems where there is a clear-cut division in these two general functions, the latter belongs in the sphere of management. Such a clear-cut division seldom exists in retirement systems generally. This may be attributed to one or more of several factors, such as size of the system, type of organization, legal provisions, the attitude of the administrative board, local precedent, and others.

There may be good reason, especially in small systems, for the board to combine with its administrative functions a close supervision over the duties of management bordering on actual management details. The tenets of functional organization would emphasize, however, the fact that the function of the administrative board should be primarily policy determining and supervising, leaving to the management board powers by means of which sound management methods may be placed in operation and made effective.

The manager should be familiar with the social, economic, and management problems which are essential to the operation of a retirement system. More than this, he may be an adviser to the administrative board; he may be the liaison agent between employees and board members; he may be the interpreter of the retirement program to the public. Finally, he should be in complete sympathy with the objectives of the system and must adapt his personal thinkings to the fundamental principles through which the system operates.

Good management being important to the success of any retirement system, the material in this chapter will be concerned with the duties and functions of management, the methods which are proving of value based on the management experiences of several systems, and the personnel qualifications which are desirable.

I. RETIREMENT SYSTEM MANAGEMENT

Management in present systems. The degree of management that may be found in retirement systems is fairly well determined by the size and type of the systems. There are records to be kept and duties to be performed which are in ratio to the number of members and beneficiaries of the system, irrespective of whether the system operates on an actuarial reserve basis or on some simpler plan. Large systems may require the services of a manager who devotes his entire time and efforts to the job. Smaller systems may have need only for a part-time manager who divides his attention between the requirements of the system and those of some other position in the governmental unit or in the department for which the system was established. The duties in the very small systems are often cared for by some officer or employee of the government as a part of his regular position.

Forty-three retirement systems reported having full-time managers. These systems ranged in number of members from a municipal police system with one hundred twenty-five active members and fifty-eight beneficiaries to a large state system for general employees with nearly ninety thousand active members and six thousand beneficiaries.

The functions of management in the two systems, because both are on the actuarial reserve basis, are fundamentally the same. The details and mechanics of management, however, must obviously be different because of the contrast in size. In the small system the manager, who has the title of clerk of the board and receives an annual salary of fifteen hundred dollars, conducts all of the business of the office without any assistance. The director, as he is known, of the large system receives an annual salary of seventy-five hundred dollars and supervises the activities of an office staff of one hundred forty-eight employees.

The efficient management of the large state system will demand from the director the ability to plan the essential duties of the office for the long-time point of view as well as for the immediate activities. He must be concerned with organizing those duties toward their proper fulfillment. He must provide the type of direction that will result in the effective control and coordination of the duties as well as of the members of his staff. He must be at once a manager of personnel and a manager of finance. The clerk in charge of managing the smaller system may be concerned with several of these management factors as they apply to his duties and to himself, but the managerial problems which he must meet and the tools of management he may use in meeting these problems cannot be compared in degree or in extent to those of the large system.

No better substantiation than these examples could be found to support the claim that it is unreasonable to attempt to develop absolute management criteria for systems so widely divergent in size and character as these are. The most that may be accomplished is to endeavor to establish fundamental bases of management as a skeleton around which the mechanics of management may be developed according to the needs of each system.

Part-time managers. The effort was made to learn how many systems required the services of a part-time manager if the system did not need one on a full-time basis. The data received were somewhat confusing. For example, the responsibility for managing the systems is very often given to the finance officer of the governmental unit, and the details incident to the management and clerical work is done by members of his office staff. In some cases the details of the job were absorbed by the staff of the board of education, the police department, the fire department, or others. Forty-three systems reported that the managerial activities were thus included with those of some other department or office. It hardly can be said that these are part-time managerial positions. Rather, the retirement system work is but a phase of the duties of the particular officer or department.

There were nineteen systems in which the information clearly indicated that the managers were on a part-time basis. That is, some officer or employee of the governmental unit gave a portion of his time to retirement system activities for which he was reimbursed by the system. This reimbursement ranged from one hundred dollars a year to nineteen hundred dollars.

Four systems retained institutions or individuals outside the government to direct their management. Nine systems replied that the administrative bodies actually handled the managerial duties.

It is not difficult to understand why a fireman, a policeman, or a civilian employee may be given the job of the part-time manager for a system which operates for the members of his department. It does, however, seem incongruous in the absence of information concerning the reasons for the choices, to combine the management of a retirement system with the duties of a clerk of the municipal court, the city traffic engineer, or the sealer of weights and measures and milk inspector. Perhaps the most striking example of a division of interests is to be found in the situation of the secretary of the retirement system who combines those duties with his municipal offices as purchasing agent, personnel officer, and director of the bureau of information and complaints.

Certainly it would seem more appropriate, because of the character of retirement system management, to place it on a part-time basis in the hands of an officer or employee of the finance department of the governmental unit.

Managerial titles. The title most commonly used for the manager is secretary, that is, secretary of the such and such retirement system, or whatever the legal name of the system may be. Thirty-eight systems give this title to their managers. The next most favored title is that of executive secretary. Other titles such as secretary to the board, clerk of the board, manager-secretary, business manager, and director are a few of many title designations in effect.

There seems no appropriate reason for suggesting the use of a uniform title. That which is preferable to individual systems is doubtless the most effective.

Managerial salaries. The annual salaries paid to the full-time managers of forty systems vary from ten hundred and eighty dollars to eighty-five hundred dollars. These quite naturally are determined by the size of the system and the degree of responsibility involved as well as local precedent in the matter of public service remuneration.

Conclusion. The development of the actuarial reserve basis for public retirement systems has brought with it the necessity for a more highly specialized management supervision than was needed in the earlier pension funds and nonactuarial systems. There are those who recommend the employment of a secretary who is familiar with and experienced in the operation of retirement systems rather than leaving the direction of the management to the head of one of the departments of the governmental units. Where this is not possible, or in systems where only a part-time secretary is needed, the fiscal nature of retirement system operations suggests the office of the chief finance officer as the logical department in which to place the managerial control.

II. THE SECRETARIAT

Maintenance of records. The retirement system secretary, subject to legal provisions and the rules and regulations of the administrative board, is generally charged with the supervision of all activities incident to the management operations of the system. Those activities may be few or many, simple or complex, depending upon the size and type of the system. Only a brief summary of the possible duties of the secretary can be given here.

The first responsibility of the secretary is to keep a full and accurate account of the transactions of the system. This entails the installation and maintenance of thoroughly devised systems of records and accounting that may be necessary to furnish from time to time detailed information so that the obligations of the system can be readily and accurately determined and calculated.

These records and accounts will provide the data necessary for the periodic actuarial computations. They will account for revenues and disbursements of whatever nature. They will provide material for financial statements and annual reports. They will make available information for budget estimates and the distribution of appropriations. They will maintain an inventory of the portfolio of investments.

There may be numerous forms applicable to the membership of the systems, forms which must be carefully prepared and maintained, because the information they contain vitally affects the benefit rights of the members and the liabilities of the governmental unit.[1] Errors in dates of birth,

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[1] See Appendix VII for a resume of possible records.

contributions by members, and service records can cause discrepancies which may be unjust, and vice versa, to members, to beneficiaries, or to the system.

The secretary must strike a happy medium in the number and type of records and accounts that are set up for the system. If the records are too numerous and complicated, there is a danger that they will be improperly maintained and therefore will prove ineffective. If the records are too few and inadequate, the possible lack of proper information may result in inefficiency in management.

Obviously, in larger retirement systems the secretary will not carry on these and other activities without assistance. As the supervisor of the managerial duties, however, it is his function to lay out and assign the work, establish procedures, and review and check the value of those procedures and the progress of the work.

Other duties. Members will continuously want information with respect to their status and their rights under the system. Nonmembers and others will seek information about the operation of the system. The secretary, or his assistants, must necessarily give time for such interviews.

Time must be given to the securing of waivers, statements, and affidavits from members and others as circumstances under the provisions of the system require. Applications for membership and for benefit allowances must be considered.

Disability and other cases must be reviewed and followed up.

Changes in laws, all amendments, opinions, decisions, and interpretations that may affect the retirement system or its members must be reviewed to assure legal compliance with their provisions.

Secretaries of systems operating in large governmental units may find it advantageous to keep in close contact with the several departments relative to matters affecting their employees and the requirements of the system. There will be conferences with board members, the finance officer, the legal adviser, and others.

In many systems the secretary has the duty of watching the portfolio of investments, investigating offerings, and preparing schedules of offerings for the board.

Correspondence must be read and dictated. Checks may have to be signed. Supplies and printing must be purchased. Reports must be prepared for board members and others. It is impossible to set forth all the varied activities which may be included in the managerial duties of the secretary. The above resume will, however, indicate the general nature of the requirements of the job.[2]

Relationship with the administrative board. The

[2] See Appendix IX for a concise statement of the duties of the secretary of a municipal teachers' retirement system.

relationship between the secretary and the board should be one of close harmony and cooperation. In large systems the board may depend upon the secretary for most of the information that is essential to its administrative functioning. The extent of the information and the manner in which it is presented will bode ill or well for the effective operation of the retirement system, depending upon the attitude of the secretary.

It is not uncommon for managers of public service activities, through long familiarity with their jobs, to adopt a domineering point of view bordering on the actual assumption of the administrative as well as the managerial functions. The board will be effective to the extent of its acquiesence in the manager's attitude. The wise manager will attempt to guide the administrative actions of the board diplomatically rather than attempt to dictate its policies.

Secretaries of retirement systems are not usually active members of the administrative body. They often do not hold the office of secretary to the board. In these situations, however, the board secretary more often than not depends upon the retirement system secretary to assist in keeping records of the board's deliberations.

Whatever the secretary's affiliation with the board, he usually is expected to attend the meetings to present those matters which require official action by the administrative body. He probably will be expected to prepare the agenda for the meeting, which will follow a prescribed or accepted form. A report on the several phases of the retirement system operations may be desired. Applications for membership, and for withdrawal and benefit allowances, will be presented for board action in accordance with the provisions or rules and regulations. Reports on the appeals and hearings of members may be in order. A schedule of security offerings may be prepared for the board. Following the board's action, the secretary may consummate the investment commitments. Also, subcommittee reports may be prepared and presented. The secretary should apprise the board members of pertinent legislative changes, decisions, and opinions.

One of the most important duties of the secretary may be the keeping of the minutes of the board's proceedings. Because the minutes should contain the official and authoritative actions of the board, it is a most valuable record. The board's authorizations, confirmations, approvals, interpretations, and other actions are important administrative decisions which affect present activities and future administrative policies. They should be accurately recorded and properly filed for safekeeping and ready reference.

The efficient secretary will index all rules and regulations, interpretations, opinions, and decisions along with the laws and amendments that apply to the system and to its members to the end that they may be readily available for reference.

The office staff. The number of employees needed by a secretary to assist him in carrying on the managerial activities of a retirement system will depend upon the size of the system as to members and beneficiaries and the requirements of the system by virtue of the type under which it is operating. Consideration must also be given to the effectiveness of the distribution of duties and whether or not modern methods and office machinery are used. It may be also that another department relieves the retirement system staff, in some governmental units, of certain record keeping, investigating, or other activities.

A few of the systems have the actuarial calculations made by members of the staff. Most systems depend upon outside actuarial assistance. The investigation and management of securities are done by the staff members of several systems. Other systems retain professional investment counsel and management. These and other differences in management technique have a bearing on the number of staff employees that are necessary.

One system with approximately forty-three thousand members maintains a staff of some seventy employees. Another system of the same basic type with nearly fifty-three thousand members and beneficiaries has an office staff of forty-two. The operating cost in 1939 for the first system, according to the information provided, amounted to three dollars and thirty-five cents per member. The second system had an operating cost per member of one dollar and fifty-five cents. The systems are approximately the same age.

A similar contrast in two other smaller systems can be shown. They both have office staffs of eight employees. One system with fifteen thousand six hundred members and beneficiaries had an operating cost in 1939 per member and beneficiary of two dollars and sixty-three cents. The second system had some sixty-five hundred members and beneficiaries and an operating cost of four dollars and two cents each.

The lack of pertinent information about the managerial set-ups and their effectiveness in these examples and others that could be given makes it impractical to attempt any conclusions as to the relative sizes of managerial staffs.

While the information has no special significance, the division of office routine among employees is of interest in that it indicates local practices. Bookkeepers, stenographers, and clerks comprise the bulk of retirement system office employees as to titles. There is no uniformity, however, in the matter of work assignments. Eight clerks comprise the staff in one system. In another there are five stenographers and one clerk, but no bookkeepers by that title. A third system has five bookkeepers and two stenographers. All of these systems have approximately the same number of office employees.

The titles used and the number of staff members are not the most important considerations in accomplishing the managerial objectives of a retirement system. True, they may in some cases affect employee morale. If so, the problem of personnel adjustments must be met. Of greater importance is that, after the respective duties have been assigned and the proper methods have been set forth, the secretary shall require of his staff absolute accuracy, neatness and clarity, and an ability to clearly visualize the steps necessary to accomplish the objectives for which the procedures have been established.

Difficulty in developing pattern for management. Up to this point the attempt has been made to indicate the range in the variety of duties that must be met by the secretaries of retirement systems. It has not been possible to be explicit in the description of managerial activities. The differences in the several types of systems precludes that possibility.

The outline of secretarial duties and relationships has presupposed the probabilities to be found in a large retirement system. The amount of detailed work in smaller systems will vary according to the number of their constituents and the form of organization. The essential factors and problems of management will be no different from that in the large systems except in degree.

Therefore, in elucidating criteria for management and the qualifications of a secretary, the most that can be expected is that a pattern which can be somewhat flexible will be presented.

III. QUALIFICATIONS OF THE SECRETARY

Difficulty in determining qualifications. What type of individual is to be desired for the position of a retirement system secretary or manager? What qualifications should the secretary possess?

An attempt to obtain the answers to these questions will place the questioner in a realm of controversy which is at once both interesting and enlightening. There is very little mutual agreement with respect to secretarial qualifications among those who are at present managing systems.

The reasons for disagreement are fairly obvious. Here again it is well to have in mind the qualifications essential in a secretary of an actuarial reserve retirement system. In the first place, the specialized nature of managerial activities in actuarial systems is not of long standing. Therefore, there are relatively few well-rounded experts in managerial capacities. Systems may largely depend upon their own staffs for handling the technical functions connected with the actuarial type of system. Others may assign the more technical activities to outside agencies and carry on only the simpler operations within their own organizations. Between these two extremes there are gradations in the assumption by retirement systems of the specialized functions. One or more may be assigned to individuals or organizations outside the systems; one or more may be handled within the system.

If for instance the investment program is carried on within the staff and the actuarial advice is procured on the outside, the qualification of investment knowledge by the manager might loom as important and that of acturial knowledge as relatively unimportant, and vice versa.

Suggested qualifications. The enabling legislation may be well written and the retirement system properly established. The board may be representative and qualified to determine through its rules and regulations the administrative policies of the system. With these conditions favorable, the success of the retirement system will still depend upon the soundness of the management. Therefore, it is vastly important that the secretary should possess high qualifications.

In an effort to learn what the men on the jobs considered the best qualifications and the relative weights which they gave to those qualifications, a section of the questionnaire was devoted to the subject.

The question was asked: "What qualifications of training are most essential in a manager; accounting, investment, actuarial, personnel and office management, general administration?" This instruction was appended: "Please indicate order of importance from 1 to 5; one being most important and five being least important."

Sixty-nine replies were received. Among those who filled out the questionnaires were full-time secretaries, part-time secretaries, board members, public officers, department heads, and employees. The majority of systems represented by the replies were on an actuarial basis.

With due regard to the fact that the replies were doubtless colored by the experiences and the thinking of the persons answering, and by the managerial set-ups of the systems, the composite answers from such divergent sources may be considered of representative value.

Reference to Table XI will give a classification of the replies in relation to the respective ratings considered most important by those who replied.

General administrative knowledge, by the composite answers, is considered to be the most important qualification which should be had by the secretary of a retirement system. A knowledge of accounting is the second most important qualification. This is followed in order by the qualifications of personnel and office management, investment experience, and actuarial knowledge.

Actuarial. It seems appropriate to again caution that the order of importance of the qualifications will vary according to the retirement system, its legal provisions, and managerial policies.

TABLE XI

QUALIFICATIONS OF TRAINING CONSIDERED MOST ESSENTIAL IN RETIREMENT SYSTEM SECRETARIES

(Data taken from statements from 69 systems. The lowest score indicates the top rating)

Qualification	Rating					Score
	First	Second	Third	Fourth	Fifth	
Administration	30	13	15	6	5	150
Accounting	15	15	23	12	4	182
Personnel	10	17	11	19	12	213
Investment	10	15	11	20	13	218
Actuarial	4	9	9	12	35	272

NOTE: The rating figures from one to five indicate the relative importance given to each qualification by those who replied--one being considered most important; five, the least important. The score was arrived at by multiplying the number of replies by the rating figure under which they are placed, then totaling the result.

Actuarial knowledge apparently is considered the least important qualification probably because most systems retain a properly qualified actuary on an advisory basis. A familiarity with the laws or probability and the methods of actuarial calculations may be of value, but it does not appear essential in a secretary in view of the fact that the actuarial science is highly technical and periodic valuations and supervision may be obtained relatively cheaply from outside professional actuaries.

Investments. A knowledge of investments is in somewhat the same catagory as actuarial experience. Nineteen systems reported that the managers advised with the board on the investment program. Doubtless a larger number of secretaries give time and thought to investment problems. Only ten replies, however, gave the investment qualification the top rating. It has already been noted that administrative boards for the most part have the responsibility of investing surplus funds, sometimes with the aid of professional counselors, oftentimes not. If the secretary is charged with the investment of retirement system money, he should possess the technical knowledge necessary to the task; if he is not, a fairly comprehensive understanding of investment principles, procedures, and terminology should suffice. It would doubtless be safer for retirement systems to retain professional investment counsel rather than to depend upon the board or secretary for investment supervision.

Personnel and office management. Where the secretary deals as he must, directly or indirectly, with members and beneficiaries of retirement systems and with his own office force, a keen appreciation of the vagaries of human nature and a knowledge of problems incident to personnel as individuals and as a group will be of valuable aid to him. The effective secretary will think of his job not simply in terms of records and office details. He will be very much concerned with the relationship which exists between the retirement system as exemplified by the administration and the management and the members. Particularly must that relationship be sympathetic and just at the time of an individual's possible transition from the status of an active member to that of a beneficiary. In systems requiring management staffs of a few to many employees, familiarity with good procedures of office management will prove helpful to the secretary. The efficiency and effectiveness with which the management routine and details are dispatched will depend largely on the office methods that have been established. The rating of third place given to the qualification of personnel and office management is doubtless fairly significant of its relative importance.

Accounting. One of the replies stated in effect that once a system has been established along actuarial lines, and the proper records set up, the system will practically run itself. The collective answers of the other secretaries who placed the qualification of accounting in second place certainly do not agree with that assertion. A number of those who replied suggested that accounting was the basic requirement. Their thinking probably is predicated upon the need of maintaining numerous complete and accurate records, not only to properly credit and account for each dollar received and disbursed, but to provide the data necessary for actuarial computations. While it may not be essential that the secretary be a certified public accountant, he ought to be sufficiently acquainted with accounting procedures as they apply to an actuarial system to understand what the books and records convey. If the secretary is not especially trained in accounting, its importance to the successful operation of a retirement system should require that a competent accountant be chosen as a member of the staff.

General administration. The composite replies placed general administration in first place among the five managerial qualifications listed, and this rating is doubtless in line with general opinion. The technical aspects of actuarial and investment procedures suggest the advisability of procuring professional counsel in these matters. Accounting and record keeping can best be done within the staff to provide for the availability of pertinent information. Trained accountants may be put on the staff to supervise or handle the accounting functions. Other relationships and functions can be supervised and carried on by staff members or by the secretary. Retirement system management requires, then, an ability and personableness on the part of the secretary which will make possible the effective coordination of all of the factors of management. The secretary may be a specialist in one of the several essential fields which are included in the operation of retirement systems, but he must endeavor to avoid the attitude of bias which oftentimes accompanied specialization. It must be his responsibility, whether the system be large or small, to assure that the retirement system, complicated as it is, will operate properly and develop harmoniously.

Legal. One qualification that was not listed in the questionnaire but is considered important by several of the managers is legal training. This also is a technical field, and nearly all systems have available the advice of the legal department of the governmental unit. A few of the large systems have a member of the legal department assigned to them. A very few systems retain outside legal counsel. The secretary need not be a lawyer, but he should have a general knowledge of pension and retirement system laws and should be thoroughly acquainted with the legislation under which his own system operates in order that all of its provisions may be complied with. Generally, however, he should depend upon legal counsel in involved matters.

Qualifications specified in the law. How far legislative provisions should go in stating the qualifications for secretaries is problematical. The laws of all but a very few of the retirement systems that were reviewed provide simply that the administrative board shall engage or appoint some one to manage the affairs of the system. Having in mind the several qualifications necessary in a secretary, it probably is just as well that the board not be bound in its selection by too rigid provisions.[3]

IV. THE SMALL RETIREMENT SYSTEM

The problem. The criticism may be made that the application of managerial methods and qualifications as presented here cannot be adequately effected in the small retirement systems. The numbers of their members and the funds available will not warrant full-time secretaries or even secretaries on a part-time basis. Further, in small communities it may be difficult to find board members or the employees who are assigned to the work with the proper qualifications and training

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[3] "The Board of Trustees shall . . . appoint a secretary who shall not be a member of the board and who shall at the time of appointment: be a graduate of a standard four year college; be at least thirty-five years of age; have had at least ten years' experience as a teacher as defined in this Act; be eligible for membership in the Retirement System as defined herein; and who shall not have held, by appointment or election, an elective office within the five-year period next preceding the date of appointment." Section 45,066-12, Kentucky State Teachers Retirement System Law.

for the efficient management of the plan.

Another factor which operates against the effectiveness and safety of a retirement system in a small municipality is the cost--costs which are made up of the expense of establishing the system, the managerial expense, the expense of periodic audits and actuarial revaluations and supervision, investment of funds, and so on. These costs on a per member basis would be relatively large and might impose too heavy a burden on a small system.

Still another factor which operates against the effectiveness of the small system is the lack of a sufficient number of members to properly spread the risks and permit the operation of the law of averages. The degree of accuracy in actuarial calculations is dependent upon the number of participants. If the number is too small, the law of averages cannot be depended upon. The types and number of benefit allowances promised by a system will determine the number of participants necessary to fairly assure safety of operation.

Even with provisions for only superannuation benefits, the minimum number of members, according to actuaries, should not be less than one hundred, and a larger number is preferable to make the calculations reliable.[4]

In addition to the other factors, the problem of having sufficient funds to allow for proper investment may be acute.

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[4] A survey of five hundred forty-five retirement systems in cities of over ten thousand population showed that one third had less than fifty members, one half had less than one hundred members, and only 11 per cent had more than five hundred members. The Municipal Year Book (Chicago: International City Managers' Association, 1938), pp. 310-18.

This also presents the difficulty of guaranteeing the rate of interest necessary to meet the benefit allowances calculated by the actuary. The result may be a decrease in the amount of the benefits or the assuming by the governmental unit of the difference between the interest earned and that guaranteed.

There are, then, four factors that tend to oppose the effective and safe operation of the small retirement system: the probabilities of poor administration and management, the high costs of operation, the danger in small groups that the law of averages will not apply accurately, and the problems of investment and earned interest on the securities.

Multiplicity of systems. Another concern to those who are interested generally in the effectiveness of public retirement systems is the multiplicity of systems within a given governmental unit. It is appropriate to discuss the problem at this point because its several ramifications are closely allied with the problems of the small system, and the solution for the one may be the solution for the other.

It is not uncommon to find within a municipality a number of retirement systems operating separately for firemen, policemen, teachers, general employees, and employees of other departments. Each system has been established by special legislation and each system operates independently of the others with a resultant increase in the tax burden to the citizens.

The development of these separate systems over a period of time may be attributed to lack of foresight and in many cases to jealousies between departments and the desire on the part of employee groups to maintain their independent status. If the employees of one department had a pension fund, why shouldn't the members of another department? As a consequence a second fund under special legislation was established. Either no thought was given to the advantages of combining the two or the selfish attitudes of the two groups prevented the joining of forces.

It must be remembered that this practice of separate systems originated before the days of the application of actuarial science to public pension funds. There was little or no thought given to the possibility of combining the membership of two systems in order that the larger number of participants might make the laws of probability more effective.

Once started on an independent existence, it is virtually a superhuman task to secure the cooperation of the several groups toward the establishment of a more effective system.

State-wide system. If the small municipalities are to have effective and efficient retirement systems, some cooperation is needed among those municipalities. A consolidation of several systems, whether within a municipality or among a number of small cities, should decrease the total costs of operation, obtain the advantages to be gained in large numbers from an actuarial point of view, and probably make possible the transfer of employees from one community to another.

As a matter of fact, probably the logical solution would be to consolidate all retirement systems on a state-wide basis. Some progress has been made toward this end, and the retirement laws of several states provide that the employees of any village or city may enter the state system.

The advantages to be gained to the employee in possible increased benefits, and the advantages to the systems in uniform administrative policies, procedures, and restrictions, under a state-wide system, would be far reaching.

If such a plan were adopted by a state, it would do away with the mass of pension and retirement legislation which has been enacted for the apparent benefit of individual groups of employees; legislation, which has been developed in piecemeal fashion and often has been inconsistent and even contradictory, if not confusing and inequitable in its application.

Possibilities for transfer. Great emphasis has been placed in recent years upon the development of careers in public service. The possibility carries with it the necessity from time to time for a governmental employee to transfer from one service or jurisdiction to another in the interests of his personal advancement. If public service is to be a career, continuity in advancement can be facilitated through transfers without loss of retirement credits that have been accumulated.

If the time comes when retirement systems can be established along uniformly broad lines and provisions are created for transfer from one system to another without loss of an employee's accumulated contributions, much will have been accomplished toward the extension of public career service.

Central control agency. Retirement systems in a few states have access to or are supervised to some extent by a state agency. In a few states a department of investments relieves the local systems of the responsibility of investing their surplus money. In other states the department of insurance supervises the operations of local systems.

Such an agency can prove of valuable assistance in providing accounting and even actuarial control. Technical information that ordinarily is not available to the small systems can be provided; periodic audits and valuations can be conducted at lower costs to the systems.

It is not suggested that central agencies of this character should be established in lieu of a state-wide consolidation of retirement systems. However, pending the establishment of a state-wide plan, a central state agency can be most effective in its supervisory and control possibilities.

The investigations of retirement systems which are underway in several states are indicative of the progress that is being made toward strengthening the operation and effectiveness of retirement systems generally and those of the small municipalities particularly.

V. MEDICAL EXAMINATIONS

Disability benefits. In those retirement systems which have provisions for disability benefit allowances there is always the opportunity for fraud on the part of unethical members. Two devices are necessary for the protection of the system, the absolute establishing of the disability before the allowance is granted to an applicant and periodic medical examinations to determine whether the disability continues to exist.

The preparation of the evidence upon which the administrative board will make its decision is a managerial function and therefore a discussion of the subject is included in this chapter. Medical examinations must be arranged and affidavits and other material must be obtained, in order that each applicant's case may be fairly presented to the board. It is euqally important that the rights of the applicant be safeguarded as those of the retirement system.

Too often have disability benefit allowances been granted on the basis of information provided by the applicant, or upon the statement of the personal physician of the applicant.[5] The only possible solution to prevent fraud is for the retirement system to provide that a physician, or physicians, engaged by the board shall make an exhaustive examination of the applicant's present physical status, and, further, that periodic

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[5] "It is probably not unfair to the medical profession to say that if an employee has made up his mind to retire, he can find some doctor, legally qualified to practice, who will certify him as unfit, if he can produce color of evidence." Lewis Meriam, Principles Governing the Retirement of Public Employees (New York: D. Appleton and Company, 1918), p. 176.

examinations be insisted upon to determine if the disability continues. The expenses of determining these facts are properly those of the retirement system.

<u>A physician's panel</u>. Applications for disability allowances cannot be standardized; therefore, the legislative provisions should be sufficiently flexible to cover all possible contingencies.

It can be stated without equivocation that disability benefits should not be allowed except upon medical certification preferably by a physician, or physicians, selected by the administrative board. As a matter of policy it should be determined whether the certification of one physician shall be sufficient or a board of two or more shall be engaged to decide the merits of the application.

One hundred twenty-four replies were received to the question, "Is a panel of physicians retained for physical examinations?" Fifty-six replies indicated that a panel was retained and sixty-eight stated that no panel of physicians was used. In answer to the question, "How many physicians examine each applicant?" sixty-six replies stated that one physician certified to the applicant's physical or mental disability, two physicians are retained by fifteen systems, three physicians are used by thirty-six systems, and one system required an examination by four physicians. These numbers doubtless do not include specialists who may be called in for advice.

A review of the legislative provisions of several retirement systems substantiated by the statements of a number of secretaries indicates that the tendency is toward the use of more than one physician to determine the fitness or unfitness of an applicant.

Five systems reported using the services of the department's physician, while the municipal medical department or physician gives the medical examinations in six systems. Forty-four systems reported that outside members of the medical profession were engaged at fees ranging from two dollars to thirty-five dollars. The usual fee allowed is five dollars.

The use of department or governmental unit physicians may probably not be criticized except where they are eligible to participate in the retirement system. To absolutely insure a fair certification of disability, it would seem wise to retain a panel of practicing physicians who have no other than a professional interest in the applicants they examine.[6]

VI. REPORTING TO THE PUBLIC AND THE MEMBERS

Public relations. One of the most important factors in the recent development of an intelligent public interest in governmental affairs has been the use of media to tell the

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[6] See Appendix X for a concise statement of medical examination provisions.

public in simple and understandable terms the how, when, where, and why of public service activities. The traditional aloofness of civil authorities and departments has been responsible in large part for the lack of interest, if not antagonism, evidenced by the citizenry toward their governing bodies. Only in recent years have governmental units borrowed the techniques of public relations from business and industry to attempt to overcome misunderstandings, reduce hostilities, and secure cooperation on the part of the public.

An appreciation of the fact that the taxpayers pay the bills of government and provide jobs for governmental officials should make it seem imperative to those officials that the public has a right to know whether its money is being efficiently and economically expended. If an atmosphere of confidence can be engendered that the public interests are being faithfully served, the end result will be a more satisfactory acceptance by the public of their duties and responsibilities toward governmental activities.

Retirement system relations. This is not the place to discuss a program of public relations for governmental units generally, but it is appropriate to set down the possibilities of bettering relations between retirement system administrations and their constituents, the public and the members.

It has been customary for retirement system administrations to think largely in terms of the members, forgetting that the public is the most important party. The interest in recent years that has been shown by groups of taxpayers and individuals in ascertaining to what extent the respective governmental units are becoming financially involved through inefficient or dishonest operations of retirement systems has called the attention of system administrators and public officials to the fact that they must reckon with the public.

The information that has been available to the public has been contained in stereotyped annual reports, which, no doubt, few lay individuals saw, containing tables of dry statistics and financial figures. The explanatory material included with the figures was usually written in prosaic and unimaginative phrases and provided on the whole most unattractive reading. It is little wonder that the public failed to learn what was going on.

Even the members have often been unable to obtain a clear understanding of their rights, benefits, and obligations under a retirement system, with a resultant lack of confidence in its administration.

<u>Annual reports</u>. It is customary for retirement system boards to prepare and issue an annual report. This report will usually cover the fiscal year of operation and should include a statement of assets at the beginning of the year, all income received and disbursements made during the year, and the balance of assets on hand at the end of the year.

All liabilities and any surplus over liabilities should also be shown. The statements and tables should give the condition of each of the several funds included in an actuarial set-up. Investment transactions should be clearly indicated.

In these annual reports it is suggested that the attempt should be made, for the sake of reader interest, to get away from the traditional type of governmental publications. Attractive formats may be used; statistics may be presented in pictorial and graphic form and will be more readily understood; statements describing the statistical material should be given in simple language; and short well-written articles elucidating the policies, objectives, and procedures of the system with complete frankness will be of aid in overcoming public suspicion. The more interesting the presentation of information, the better its effect will be.

Information to members. Means ought to be provided to maintain a closer contact between the members of a retirement system and the administrative board. Members are entitled to know what is going on, what the financial condition of the system is, and what the future holds. They should want to know what legislative changes are made that affect their membership as well as administrative interpretations and rulings.

Specifically, members should be given occasionally definite information on their status, rights, and privileges in the system. It is no doubt true that many members approach the time of their retirement without clearly knowing the amount of the allowance they will receive. Particularly is this true in regard to annuities which are dependent upon the employee's deposits, age, sex, and the mortality experience of the system.

Different plans are used by the several systems. Generally the annual report is available to members. The reports of some systems contain the annuity tables that are in effect at the time with methods for determining one's annuity. In some systems periodic individual reports of the status of each member's account are provided; in others, statements for individual members are provided upon request.

The use of bulletins of information, or primers, is an acceptable method of providing members with pertinent material. Periodic news bulletins are published by a few systems.

Working and informational manuals.[7] A technique of management which is too seldom used in governmental activities is a working manual which, if properly prepared, may also be made available as a booklet of information.

To the secretary and his staff a working manual will prove an important tool of management. To board members, especially new ones, the manual will prove of value in gaining a background of administrative functions and practices

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[7] W. F. Willoughby, Principles of Public Administration (Baltimore: The Johns Hopkins Press, 1927), p. 186.

upon which may be predicated future thought and action. If available to members and to the public, the manual can be effective in presenting information relative to the history, objectives, organization, and operation of the retirement system.

The contents of such a manual will depend largely upon the use that will be made of it. One for general consumption might contain a statement of the reasons for the creation of the system, its establishment, and a history of its development; a statement of the objectives and functions; a description of the administrative and managerial set-ups; briefs of the enabling legislation and amendments; a summary of rules and regulations, interpretations, opinions and decisions; a review of the financial operations of the system over a period of years; data on number of members and beneficiaries, and methods of determining their contributions and benefits.

If the manual is primarily for the administrative board and the managerial staff, the details of procedure may be enlarged.

The effective value of the handbook will depend upon the material included and the manner in which that material is presented. Brevity and readability should be the keynotes.

Conclusion. A wholesome attitude on the part of the administrative board and the managerial staff with regard to their responsibility to the constituents of the retirement system will do much to overcome a critical attitude and create the confidence so essential to cooperative endeavor.

It is not enough to provide complete and attractive reports and bulletins, or to make frequent use of newspaper publicity and other media which may be available. The entire atmosphere created by the central office staff, whether in personal interviews, through telephone conversations, by correspondence, or through other methods of intercourse, should be one of a courteous understanding of the problems of those with whom it deals. The secretary and the administrative board should insist upon this.

VII. THE EFFECTIVENESS OF MANAGEMENT

Need of improvement. It is unfortunate that the retirement systems that have the greatest need of effective management are those in situations where that management for any of several reasons is not available. Size, lack of finances, organizational set-up, precedent, official prejudice, and other factors may be the cause, or causes.

As the fundamental concepts of objectives and types of organization in retirement systems have developed through the years, it may be hoped that the qualifications and techniques of management will likewise develop to a more effective state.

Managerial attributes. Certain of the operations incident to actuarial retirement systems are highly technical and require from the secretary a familiarity with their objectives and procedures if the management is to be effective. Boards of administration should insist, even in the small systems, that those who are charged with the details of management shall possess certain attributes essential to management in any line of endeavor. Handing the job to any available employee or individual is to place dependence on guesswork and luck and not on management principles. Certain it is that somewhere along the line someone can be found who will possess a modicum of managerial characteristics.

He should have the ability to fully comprehend the objectives for which the retirement system was established. He should have had sufficient training and experience to enable him to develop the procedures necessary to carry out those objectives efficiently. He should be appreciative of constructive criticism, open minded, and unprejudiced. One who is a slave to precedent and prejudice has no business to be in a managerial position. He should be at once a servant of the administrative board and its guide. He must represent the members in their dealings with the board. He must represent the board in its relationship with the members. His personality, tact, and ability should command the respect of those with whom he comes in contact in his official capacity.

The more closely a secretary can approach these attributes the more effective his managerial results will be.

CHAPTER VII

THE CIVIL SERVICE RETIREMENT AND DISABILITY FUND

A discussion of public retirement systems would not be complete without some mention of the Civil Service Retirement and Disability Fund for certain classes of employees of the United States government. With a membership of better than six hundred thousand, it is by far the largest retirement system in the country.

I. PROVISIONS OF THE FUND

Description. The Civil Service Retirement and Disability Fund was established by law on May 22, 1920, and commenced operation in August of the same year. The Fund was the culmination of a number of years of agitation and discussions to provide some retirement benefit for civil service employees of the federal government.

The principal purpose of the Fund was to provide superannuation benefits but provision was also made for disability benefits to beneficiaries who could qualify, and for withdrawal allowances.

It became evident soon after the Fund was set up that there were many weaknesses in the provisions of the Act. Attempts to strengthen those provisions and the operation of the Fund have resulted in numerous changes being made in the original law through legislative amendments. The present discussion of the provisions of the Fund includes the changes which were made up to August 4, 1939.[1]

Members contribute 3½ per cent of salary through payroll deductions. Additional sums of money may be paid to the Fund by a member and these are added to his accumulated contributions, which are used to purchase an annuity upon his retirement. The 1920 legislation required employee contributions of only 2½ per cent.

The original Act did not require any definite appropriations by Congress as the government's share of the cost of benefits. The Act authorized the Secretary of the Treasury to credit to the Fund, in addition to the contributions by employees, "all moneys received in the form of donations, gifts, legacies, or bequests, or otherwise . . ."[2] The Act did provide, however, that there should be submitted to the Bureau of the Budget each year "estimates of the appropriations necessary to finance the retirement and disability fund and to continue this act in full force and effect."[3]

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[1] Public Act No 263, 76th Congress, amending the Retirement Act.

[2] The Civil Service Retirement Act with Annotations and Regulations (Washington, D. C.: United States Government Printing Office, 1935), p. 49. Section 10.

[3] Ibid., Section 17, p. 64.

In spite of the repeated recommendations by the Board of Actuaries in an effort to place the Fund on a sound actuarial basis, no appropriations were made by Congress until 1929. Annual appropriations have been made since that time, but only in 1938 and 1939 did the amounts of the appropriations approximate the sum suggested by the Board of Actuaries. Although the attempt originally was made to establish the Fund on an actuarial basis, the failure of Congress to appropriate the government's share of the benefit costs made it necessary for the benefits of one group of employees to be paid from the contributions of another group.

The Civil Service Retirement and Disability Fund, therefore, operated for years on a cash disbursement basis in the evident hope that sooner or later the government would make good the inevitable deficiency.

Benefit provisions.[4] Retirement for old age is compulsory upon reaching the normal retirement age if the employee has completed fifteen years of service. There are three classifications of employees as to retirement ages. General employees are required to retire at seventy. Two other groups retire at sixty-five and sixty-two, respectively.

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[4] Material for this discussion was taken largely from the Nineteenth Annual Report of the Board of Actuaries, Civil Service Retirement and Disability Fund (Washington, D. C.: United States Government Printing Office, 1940), pp. 2-4.

> The amount of the benefit is equal to $30.00 multiplied by the total number of years of service not in excess of thirty (provided that this part of the allowance does not exceed three-fourths of the average annual basic salary[5] and is not less than the annuity from employee's credited contributions), plus the annuity which the employee may purchase with the amount credited to his individual account including interest accumulations. The minimum total annuity payable is equal to one-fortieth of the average annual basic salary, not in excess of $1,600, multiplied by the number of years of the employee's service, not in excess of thirty.[6]

An employee who has had a minimum of five years of service is eligible for a disability retirement allowance, the amount of which is determined by the method used for old-age retirement allowances.

Employees of forty-five years of age or over, provided they have allowable service of fifteen years or more to their credit and who are not eligible to retire for age, may receive a discontinued service benefit if they lose their employment through no fault of their own. This allowance may be the employee's accumulated contributions with interest or an annuity under one of two plans.

The employee's accumulated contributions with interest at 4 per cent compounded annually may be received by an employee who voluntarily leaves his position or who leaves

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[5] The average annual basic salary is used to denote the average salary received by an employee during any five consecutive years of service. The employee may make the choice of years to be used.

[6] *Nineteenth Annual Report of the Board of Actuaries*, *op. cit.*, p. 2.

involuntarily because of misconduct or delinquency. This same allowance is made to the beneficiary of an employee who dies in service prior to retirement.

Upon death following retirement, the beneficiary of a member may receive the remainder of any amount that may exist between the annuity payments which the member's contributions provided and the actual amount of the contributions. At the time of retirement a member may elect one of several optional methods of receiving the allowance due him.

Amounts of benefit allowances. As of June 30, 1939, there were 58,385 beneficiaries on the roll of the Civil Service Disability and Retirement Funds. The average benefit allowance paid during the 1939 fiscal year amounted to $978.[7]

Of the total number of beneficiaries, 35,634 have been retired on account of age and for voluntary and involuntary separation from the federal service. The average annual allowance for this group is slightly over one thousand dollars. The second largest group of beneficiaries has been retired on account of disability. There are 14,315 of these and the average annual allowance amounts to $801. The highest average allowance is paid to those beneficiaries who were retired on account of involuntary separation after

[7] Retirement Report, United States Civil Service Commission (Washington, D. C.: United States Government Printing Office, June 30, 1939), p. 5.

thirty years of service. Their benefit payments amount to on the agerage $1,166.[8]

Section 6 of the Retirement Act provides that medical examinations to determine the eligibility of an employee for a disability retirement allowance shall be given by a medical officer or officers of the United States. Where these are not available, the central office may designate a practicing physician, or physicians, to examine and report on the condition of the applicant. Disability beneficiaries must submit to further medical examination each year.

II. SUPERVISION AND CONTROL

Administration and management. The United States Civil Service Commission administers the retirement fund and directs the activities of the manager who has the title of Chief, Retirement Division, United States Civil Service Commission. The manager's staff numbers approximately one hundred fifty employees. These are included in the following classifications: assistant chief, legal advisers, contact advisers, examiners, ajudicators, legal reviewers, file clerks, and stenographers.[9]

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[8] Nineteenth Annual Report of the Board of Actuaries, op. cit., p. 5.

[9] Taken from questionnaire completed by the Chief of the Retirement Division, Civil Service Commission.

The mandatory contributions of the members are deducted from salaries at payroll periods by direction of the Comptroller General. The money is deposited in the Treasury of the United States. The Secretary of the Treasury is the custodian of the money belonging to the Retirement Fund and makes the necessary disbursements upon authorization of the Retirement Division. Contributions by employees amounted to $39,189,390 for the fiscal year ending June 30, 1939.[10]

No audit of accounts is required by law. Audits are made, however, by the General Accounting Office and a statement of the financial condition of the Fund is included in the annual report published by the Civil Service Commission. The expenses of administration and management of the Fund are provided for through Congressional appropriations.

The Board of Actuaries. The retirement fund legislation provided for a board of three independent actuaries to supervise the actuarial operation of the Fund. This board each year reviews the progress of the Fund and submits to the Civil Service Commission a report. The board is also given the responsibility of revaluating every five years the rates upon which the actuarial computations are made.

A weakness in the mechanics of management which has been apparent in the operation of the Fund is a failure to

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[10] *Loc. cit.*

plan and maintain the system of records needed to expedite the collection and tabulation of the information required for the five-year valuations. As a result, the actuarial valuations and appraisals of the Board of Actuaries have not been completed until several years after the expiration of the quinquennial valuation period.[11]

Finances. It has already been noted that the Retirement Act does not set a definite percentage contribution which shall be payable by the government to provide the share of the benefits for which it is responsible. Under a plan submitted by the board of actuaries after years of recommendations, Congress has appropriated each year since 1929 a sum of money for the Fund.

The government has two responsibilities to the Fund. One is to appropriate a sufficient amount to meet its normal contribution for current service. The other is to make an annual deficiency appropriation to cover the cost of benefits payable on account of services rendered prior to the establishment of the Fund.

By the end of the 1937 fiscal year, because Congress had failed to make the appropriations indicated by the valuation figures as necessary, the liability for past service

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[11] Sixteenth Annual Report of the Board of Actuaries, Civil Service Retirement and Disability Fund (Washington, D. C.: United States Government Printing Office, 1937), p. 17.

amounted to over 1,174 million dollars. The Board of Actuaries in its sixteenth annual report estimated that an annual payment of $51,318,167 for approximately sixty-three years from 1935 would be needed to meet the accrued liability deficiency.[12] In 1939 the actuaries estimated the annual needed appropriation had increased to $69,419,946.[13]

In a retirement system administered and managed on a sound basis the usual course is for the proportion of assets to the liabilities to increase from year to year until the assets eventually are sufficient to cover the liabilities both for current employee service and for past employee service. In the federal retirement system the "liabilities on account of prospective benefits to active members have increased about 11 per cent and the liabilities of the fund as a whole by about 29 per cent."[14]

In brief, the financial history of the federal retirement system shows an institution with liabilities in excess of two billions of dollars upon which more than six hundred thousand public employees are depending for adequate retirement benefits. It is an institution established by a paternalistic Congress, but to which no appropriations were made

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[12] Ibid., p. 14.

[13] Nineteenth Annual Report of the Board of Actuaries, op. cit., p. 7.

[14] Sixteenth Annual Report of the Board of Actuaries, op. cit., p. 15.

during the first eight years of its existence. During the years 1929 to 1935 annual appropriations were made, but the amounts were not sufficient to cover the government's share of benefit costs for current employee service alone. In 1936 and 1937 the appropriations slightly exceeded the current normal costs; and in 1938 and 1939 they approximated the amounts suggested by the Board of Actuaries as necessary to cover the accrued liability costs as well as the normal costs.

The Civil Service Retirement and Disability Fund will not be considered financially sound, in line with present thinking, until the annual appropriations by the government more closely approximate the figures determined as reasonably adequate by the Board of Actuaries.

Investments. The supervision of the investment of the surplus funds of the retirement system is a responsibility of the Secretary of the Treasury. Investments are limited to interest bearing securities of the United States and to federal farm loan bonds.[15]

The balance in the fund at the close of the 1939 fiscal year amounted to $468,755,408.38.[16]

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[15] Retirement Act, *op. cit.*, Section 11.

[16] Taken from questionnaire completed by the Chief of the Retirement Division, Civil Service Commission.

No interest is directly assumed by the Retirement Fund except for withdrawal from the service. In these cases 4 per cent interest compounded annually is allowed.

Since the establishment of the Fund, earned interest has amounted to 13 per cent of the total receipts. Employees have contributed 49 per cent, and government appropriations have amounted to 38 per cent.

III. CONCLUSIONS

The Civil Service Retirement and Disability Fund was established for the purpose of providing, essentially, old-age retirement benefits for federal employees. The formation of the system was doubtless inevitable because of the continual urging by those who were interested in caring for superannuated employees and in strengthening the federal service.

It is unfortunate that more consideration was not given, at the time, however, to the adoption of legislative provisions which were inclusive and at the same time precise. Something more than a score of amendments have been added to the Retirement Act during its twenty years of operation, and still the Fund cannot be said to be a sound retirement system.

Because of its size and because it is the system adopted and operated by the central government, it might be hoped that it could have been a model for state and municipal governmental units to follow in caring for their old and disabled employees. However, until some systematic and effective method of financing the government's share of the benefit costs is developed and followed, the Fund certainly offers no proper precedent for other public retirement systems to follow.

CHAPTER VIII

EVALUATION OF PUBLIC RETIREMENT SYSTEMS

This study has been primarily interested in the policies, procedures, and practices incident to the administration and the management of public pension funds and retirement systems. In order to establish a basis upon which the subject matter could be developed, a short historical background was given and the several types of systems were briefly described.

Many of the facts used in the discussions of the various administrative and management factors were supplied by the experiences of a number of systems and individuals. Other information was procured from writings on the subject.

It is now appropriate to summarize as succintly as possible the material that has been presented and to attempt to draw certain conclusions from an evaluation of that material. In addition, some generalizations as to probabilities doubtless should be stated because the objectives for which pension funds and retirement systems have been established are very definitely tied in with the whole program of social security. The application through legal measures of phases of social security to public service employees may radically affect the operation of present retirement systems. Therefore, it is expedient that some consideration be given first to that possibility.

Following this, the several phases of retirement systems will be briefly reviewed, and a summary of the factors of a sound retirement system will be attempted.

I. THE SOCIAL SECURITY SYSTEM

Background of the legislation. The possible extension of one or more phases of the Social Security Act to public service employees might have such an important bearing upon the future operations of public retirement systems that a consideration of its implications is worth while.

Why were public employees not included in the provisions of the original Act? What effects may result in the operations of present public retirement systems if public employees are later included? The answers to these and other similar questions are noteworthy in any attempt to forecast the future development of retirement systems.

The Social Security Act was signed by President Roosevelt on August 14, 1935. The Act was the culmination of sporadic and isolated efforts to secure means whereby the American people, more especially the workers, might be protected against insecurity during periods of economic stress and strain and against dependency in old age. The enactment of the Act was the immediate result of a comprehensive study of the problem by the Committee on Economic Security appointed by the President in June, 1934.

The provisions of the Act related to economic and social security for individuals under four general headings: federal old age benefits, unemployment compensation, public assistance, and public health and welfare.

Rather than say the Act was the culmination of efforts to obtain security for those who without aid are unable to protect themselves against the hazards of dependency, it may be better to say that the Act provided a framework for the development of a comprehensive nation-wide social security program.

The original Act in addition to specific provisions for social insurance charged the Social Security Board with the duty of studying social legislation and of making recommendations for its progressive development. As a result, the experiences of the first four years brought the submission of proposed amendments to broaden and strengthen the protection that had been offered, looking particularly toward greater security for the family as well as for the individual. The amendments were passed by Congress and became law on August 10, 1939.

<u>Present program and administration</u>. There are ten distinct activities in the present social security program. These are: employment security, old-age and survivors' insurance, old-age assistance, aid to the needy blind, aid to

dependent children, child-welfare services, services for crippled children, maternal and child-health services, retraining for disabled workers, and public health services.

The old-age and survivors' insurance program is the only one administered in its entirety by the federal government. The others are administered by the several states with federal cooperation and financial assistance. The old-age and survivors' insurance program is administered by the Social Security Board, composed of three members, with the cooperation of the United States Treasury. This board in addition is the federal agency set up to work with state agencies for employment security, old-age assistance, aid to the blind, and aid to dependent children. The function of the board in these four federal and state programs is to approve the state plans and their administration and to certify to the Treasury the payment of the federal grants to the states.

The Children's Bureau of the Department of Labor cooperates with the states in administering the services for child-welfare, crippled children, and the child-health service. The Office of Education is the federal agency for the service of retraining for disabled workers, and public health services are under the charge of the United States Public Health Service.[1]

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[1] What is Social Security? Social Security Board, Federal Security Agency (Washington, D. C.: United States Government Printing Office, 1940), pp. 4-5.

Old-age and survivors' insurance. Under the present Act public service employees are excluded from old-age and survivors' insurance coverage, but their inclusion is a matter of current discussion; therefore, it is appropriate to note the provisions of the Act.

The old-age and survivors' insurance plan is designed to provide economic security for workers and their families when the wage earner stops work because of age, or if he dies. The object is to enable workers and their families to avoid dependency upon governmental support. Annuities based upon the contributions, through special taxes, of employees and employers are created.

Retirement benefit payments are thus provided under provisions of the law for the employee, his wife, and his children. Survivors' benefits are paid to children, to the widow, or to dependent parents who qualify under the provisions of the Act.

The tax levies and the benefit payments are made directly by the federal government; therefore, this phase of the social security program requires no state legislation or administration.

Public employees not included. The reasoning back of the adoption of the old-age insurance plan is similar to that which produced contributing retirement systems for public employees. Large numbers of elderly people are unable to effectively continue working. They are dropped from or cease their employment without any means of support other than a dependence upon their families or upon the government. The contributory plan of old-age insurance was advocated, therefore, to make it possible for workers to provide for their old age and for the welfare of the dependent members of their families.

Why were public employees not included in the provisions of the Social Security Act? Apparently there was a feeling on the part of the members of the Senate Committee who studied the original proposal that a large proportion of public employees was protected by public pension plans and retirement systems. Also, the problem of federal and state relationships with possible difficulties in securing legislation necessary to make the Act effective would have to be met. Administrative problems were likewise involved, and, as always in programs which may affect public employees, the political strength of public employee groups must have been considered. The proposed legislation was a new departure, and its provisions were not clearly understood by the rank and file of those who would be affected by it. The sponsors of the Act, therefore, for purposes of strategy, doubtless decided not to complicate the issue by the inclusion of public employees with the probabilities of strong opposition by them. After all, if the social insurance experiment worked, later amendments might be passed to cover those groups that had not been originally included.

Shall public employees be included? Since the inception of the Act some officials of state and local governments have indicated a desire for the coverage of public employees under the old-age and survivors' insurance plans. On the other hand, the members of some public retirement systems have voiced opposition to any proposed extension of the plan to include public employees. The Social Security Board apparently favors the broadest possible extension of the coverage of the old-age and survivors' insurance phases of the Act and is actively interested in effecting some method of coordination between the various public retirement plans and the general social security program to that end.[2]

Problems to be faced.[3] In any consideration to extend

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[2] " . . . There is a large area of public employees without any local protection at all. There is a problem of providing adequate protection for employees who shift between local service and federal service and private business. There is a loss to state and local employees of many millions of dollars in insurance value for survivors through the present excluded status of public employees. The correction of these situations through extension of the Social Security Act with the coordination of existing plans can but result in a considerable over-all improvement in the general welfare of the employees." Quoted from a personal letter from an official of the Social Security Board's Office.

[3] Material for this discussion was largely taken from Summary of Proceedings, Informal Conference on Extension of Old-Age and Survivors' Insurance under the Federal Security Act to state and local employees, November 25, 1940, sponsored by Municipal Finance Officers Association, Chicago.

the old-age and survivors' insurance phases of the Social Security Act to cover public employees a number of possible problems must be recognized. It is estimated that approximately one and one-half million public employees are not included under the Social Security Act or in federal, state, or local retirement systems. These employees, as nearly as can be determined, make up about 60 per cent of the total number of public employees. It is felt, therefore, that the insurance protection provisions of the Act should be extended to them.

Another group of public employees are members of retirement systems that provide old-age benefits but do not provide benefits for the survivors of members. It is estimated that only 20 per cent of the public employees who are members of retirement systems have adequate survivorship protection. Survivors' benefits for widows, children, and parents in accordance with the provisions of the Act might well be extended to the 80 per cent of retirement system members not presently covered by such provisions in local systems.

A third group of public employees are members of retirement systems the financial soundness of which and, therefore, the adequacy of the protection promised to those employees, may be questioned. Here again, the employees might be in a safer situation with regard to retirement allowances under the Social Security Act.

Workers at present included in the Social Security System may transfer from one employment to another without loss of the old-age benefit accumulations credited to their accounts. This is not so with the public employee even though he be a member of a retirement system. In a few statewide and local systems, employees may transfer from one jurisdiction to another without loss of status in retirement and other credits. Generally, however, the member who changes his employment receives his contributions, plus interest, but loses the accumulated credits toward his retirement annuity and pension. The Social Security Act could provide a continuity of protection for employees who transfer from one employment to another whether it be from public to private employment, or vice versa, if public employees were included in the system.

The constitutionality of legislation which would permit the levying of taxes by the federal government upon states and local governmental units for the purpose of collecting the employers' contributions to the system may be questioned. Only through a test case following the passage of the legislation could this fact be determined. The delay incident to such a test case could be detrimental to the interests of existing retirement systems. Other legislation by states and municipal units to legalize the payment of the necessary taxes and to adjust contractural relations between governmental units might further delay and complicate the operation of the plan.

What would become of the accumulated reserves of retirement systems were all public employees included in the Social Security System? If the members of strong retirement systems were exempted from the provisions of the legislation, what standards would be used to determine which systems were strong and which were not?

These problems are but a few of the many to be considered and solved as adequately as is possible before public employees can be made eligible for the old-age and survivors' benefits of the Social Security Act.[4]

<u>Probabilities for the future</u>. It is impossible to know what proposals will result from present studies being made by the Social Security Board and other interested persons and groups. Three possible programs have been suggested, none of which, quite naturally, would receive the wholehearted support of all of the groups that would be affected.

One proposal "would provide compulsory coverage for all state and municipal employees regardless of existing retirement systems." Under this plan present retirement

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[4] See Appendix XI for objectives to be accomplished and proposed plans to extend federal insurance coverage to public employees.

systems would doubtless be modified so as to supplement the federal plan to provide "as much or more old-age protection as the systems now have."[5]

In the second proposal only those public employees who are not members of a retirement system would be covered by the Social Security insurance provisions. Members of existing systems would be left out of consideration.[6]

The third proposal would provide for those public employees of states and other governmental units who through voluntary agreements with the social security system elected to accept coverage under existing provisions. Retirement systems already organized could, upon agreement, become supplementary to the federal system.[7]

Even the brief descriptions of the several proposals which have been given here are sufficient to indicate the nature of possible legal, administrative, financial, and political objections that might be raised.[8]

<u>Conclusion</u>. Regardless of the proposal that may be most acceptable for immediate future enactment, it appears to be evident that the Social Security program with its several

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[5] <u>Ibid</u>., p. A.

[6] <u>Ibid</u>., p. D.

[7] <u>Ibid</u>., p. F.

[8] See Appendix XI for more complete statements of the proposals.

ramifications has become permanently established and that it will be added to as conditions warrant. It is very likely that future amendments to the Act will compel the inclusion of all public employees in the Social Security System, thus requiring modifications in existing retirement systems which may radically alter the entire scope of their administrative and managerial procedures. This problem is one, however, that can be met only in the future.

An extension of the Social Security System to cover public employees can be forestalled only through a reorganization of existing weak retirement systems to provide members with future benefits comparable in amount and safety with those of the federal plan. Also additional systems must be established to insure all public employees who are not at present members of any retirement plan, plus the development of reciprocal relations between governmental units to allow for the transfer of employees from one jurisdiction to another without loss of accumulated benefit credits.

II. PHASES OF RETIREMENT SYSTEMS REVIEWED

Development of retirement systems. Pensions for public servants were among the first forms of social security. They were established through motives of gratitude to employees grown old in public service, to compensate employees for low wages received in governmental jobs, or to encourage employees such as police and firemen whose work exposed them to physical hazards.

In the early systems the employees paid little or nothing toward their pensions. If contributions were made, the money usually was used to pay the pensions of those already retired. No reserve funds were accumulated. Through the insistence of employee groups legislators from time to time increased the benefit allowances, and these in turn brought liabilities which frequently could not be met when the benefits were due to be paid.

Starting with the establishment in 1857 of the pension fund for policemen in New York City, there have been set up from time to time in the various states and their local subdivisions pension funds and retirement systems for the benefit of individual groups. These systems have for the most part developed independently with no semblance of uniformity in legislation, amounts to be contributed, benefits to be given, or administrative procedures. The development has been definitely haphazard with very little consideration given to long-term planning.

As a result there are in existence throughout the country, because of the action of various groups of public employees, a large number of independent retirement systems the financial safety of which may be seriously questioned.

Sources of revenue. The costs of benefits in some of the systems are borne entirely by the governmental unit. In a few systems the members provide all of the revenue through their contributions. Most of the systems are jointly contributory. In these the cost is divided between the employees and the governmental unit. There is, however, virtually no uniformity as to the proportion of funds contributed by the members and the government, or the percentage of contribution made by the employees.

Retirement provisions. The conditions of retirement are based on age, length of service, or both. The age requirements vary from fifty to seventy years and the service requirements vary from no requirement to thirty-five years. Certain systems have established a minimum retirement age following which members may retire and a maximum retirement age which compels retirement.

Benefits allowed. The number and amounts of promised benefits differ widely. Some systems pay a flat sum as a retirement allowance regardless of salary. Others base the retirement allowance on salary, either the terminal salary or the average salary for a determined number of years. Sometimes a maximum retirement allowance is set up. One or more of several other benefits may be provided, such as disability, death, or withdrawal. With these also there are wide differences both in the amounts promised and in the methods by which the amounts are determined.

Types of systems. The bases upon which public retirement systems operate are of three general types. The cash disbursement plan, in which all benefits are paid from current revenue, is the least desirable and has been the reason for the financial distress of many systems. The partial reserve type provides for the accumulation of each employee's contributions in reserve funds looking to his retirement; the governmental unit does not make any contributions for the individual employee until he retires. The most effective systems operate on a full actuarial reserve basis in which the benefits bear an actuarial relation to the reserves that have been built up. The acceptance by the governmental unit of the accrued liability, the liability incurred through service rendered by employees before the system was established, is a feature of the third type of system.

Legislation. Unfortunately the legislation that establishes retirement systems has for the most part been poorly prepared. In most systems the laws have been enacted through the selfish efforts of groups of employees who gave little thought to other than their own immediate benefit. Frequent changes have often been made to expand the provisions of the system resulting in a hodgepodge of ineffective pension legislation and placing large financial burdens on future generations of taxpayers. Inefficient and even dishonest administration has often resulted from a failure to include satisfactory control provisions in the law.

Administration and management. The majority of public retirement systems are poorly administered and managed. The smaller systems, especially, do not have access to the quality of administrative acumen so essential to the effective administrative control of public organizations. The management of the systems often is lacking in adequate training and experience, and the methods used are archaic. Adequate measures of control to insure the safety of funds and investments have not been provided. Even though a retirement system is established in a most auspicious manner, the degree of success it attains will be dependent largely on its administration and management.

III. FACTORS OF A SOUND RETIREMENT SYSTEM

Sound retirement systems are possible. No longer is it appropriate to think in terms of gratuities, rewards, and motives of charity in setting up a retirement system for public employees. "The primary reason for the expenditure of money by a government in the inauguration and maintenance of a system of retirement lies in the advancement of the true interests for which the government exists."[9] The

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[9] Henry S. Pritchett, The Social Philosophy of Pensions (New York: Carnegie Foundation for the Advancement of Teaching, Bulletin No. 25, 1930), p. 8.

essential reason, therefore, for providing retirement allowances for employees in the public service is to improve the efficiency of the personnel. If the public service is to be kept on a most effective basis, old and disabled employees must be retired.

Further, if the public service is to attract and retain suitable men and women, a reasonable promise of permanency of tenure is necessary, and the maintenance of a sound retirement system is a means to this end.

A public retirement system should, then, be established and developed as a part of a long-term personnel program. The needs of the future should be considered as important as those of the present. The interests of the public as the employer and the provider of funds as well as those of the employee should be reasonably safeguarded. The employee has a right to the guarantee that sufficient reserves will be accumulated with which to pay the benefit allowances promised him. The public should be protected against the careless or dishonest dissipation of its share of retirement funds.[10]

These objectives are not difficult of attainment if local prejudices and the selfishness of certain employee groups can be overcome. Sufficient experience in the field of public retirement systems has been had to provide any

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[10] Herman Kehrli, Minneapolis Pension Systems (Minneapolis: Taxpayers Association, 1932), Introduction.

governmental unit of effective size with material to insure the establishment or reorganization of a well-balanced and comprehensive system. An actuarial system set up on a full reserve basis, which includes provisions that will be all times keep revenues and disbursements in balance, and operated in conformity with sound business practice with proper administrative controls to prevent discrimination or abuse in the handling of the affairs, can be maintained on a solvent basis with no need of future anxiety to the members or to the public.

The importance of proper legislation. This consideration of the factors of sound retirement system administration and management presupposes that the plan decided upon will be the actuarial reserve. The dangers of other plans have been so effectively illustrated by the financial difficulties experienced in so many systems that it hardly seems worth while to belabor the point.

Under the actuarial reserve plan, both the employee and the government bear a proper share of the obligation they assume. The costs of the promised benefits are known. The system can readily be maintained on a solvent basis if businesslike methods are used. The costs of benefits are borne to a large extent by earned interest. The only valid arguments against the plan is that it is complicated and more expensive to operate.

Once the plan has been decided upon, it is important that the enabling legislation be properly drawn. The piecemeal pension legislation which has been developed in many governmental units is in no way a credit to its proponents or to the public service. Adequate controls for administration and management, provisions for periodic actuarial valuations and audits, restrictions as to the investment of funds, the requiring of fiduciary bonds from those who handle the funds are all important to the sound administration of public retirement systems.[11]

The financing provisions are of great importance. The several reserve funds which are to be maintained should be clearly described, and provisions should be made to insure the setting up of proper records and accounts.

The interest rate upon which annuities are computed has been guaranteed in many systems with the result that difficulties have been experienced during the recent period of low yields on securities. A flexible feature that will avoid this difficulty can be included by a provision that no specific interest return will be guaranteed, and that rates on which annuities are computed will be redetermined periodically on the basis of the actual experience of the system.

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[11] William H. Sherman, _A Suggested Retirement System for Employees of Small Municipalities in Minnesota_ (Minneapolis: University of Minnesota, 1938), p. 33.

The amount of the employees' contributions may be varied from time to time to maintain the stated annuity level, or rate increases may be avoided by a reduction in benefit allowances. Whichever plan is found mutually desirable and advantageous should be used.

The costs of operating a pension system can be increased or decreased materially depending upon the control that is exercised over the medical examinations which are given to determine eligibility for disability benefit allowances, and the follow-up examinations given to disability beneficiaries. Preferably a board of two or more independent practicing physicians should be provided for, and this board should be given authority to engage whatever additional specialized service appears necessary. The medical board's report in writing, accompanied by pertinent exhibits, on each application, will form the basis upon which the administrative board's decision will be made.[12]

While in theory it may be politic for the legislation to give administrative boards broad powers of policy formulation, the experience of present systems would indicate that the legislative provisions should be definite and exact, leaving very few discretionary powers to the board.

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[12] For a brief description of all provisions to be included in the enabling legislation see Retirement Systems for Public Employees (Chicago: Municipal Finance Officers Association, 1938), p. 6.

<u>Administrative factors</u>. The successful functioning of the New York State Retirement System without benefit of an administrative board may be the beginnings of a change in retirement system administration from the board to an individual. Both types of control have their advantages. However, the American way for public service activities such as retirement systems still favors administration by a board.

Boards should be small enough to provide direct and quick action and large enough to properly represent all interests concerned. Administrative boards of three, five, or seven members should be adequate for retirement systems generally. The board membership should be representative of the employing body and of the employees, preferably on an equal basis. There may be good reason to have the public represented by one or more lay members.

The chief finance officer of the governmental unit usually should be a member by virtue of his office. Other public officials may hold membership if their positions or their experience make them valuable to the body. The employee members of the board will usually be elected by their fellow members.

The terms of the several board members should overlap so as to insure continuity in policy and procedure. Terms should be sufficiently long to permit a new member to participate effectively, but not so long as to stifle the possibilities for progressive action.

Political control has no proper place in public retirement systems, and the provisions for the election or the appointment of board members should as far as possible assure a nonpartisan membership.

The attitude which board members assume toward their duties and the ability they exercise in the performance of those duties will very largely determine the effectiveness and the success of a retirement system.

<u>Management factors</u>. The point cannot be emphasized too strongly that the functions of the administrative board should be primarily that of determining policies and adopting rules and regulations to further those policies. The actual management of the system should be given over to a secretary. There are a number of small systems in which the board members participate in managerial activities. Where a system is too small to engage even a part-time manager, it is too small to operate on an actuarial reserve basis.

The secretary should be appointed by the board and ought to have the highest managerial qualifications as well as an understanding appreciation of the objectives for which the system was established. If a staff is possible, the secretary should be permitted to engage those assistants who will efficiently transact the routine duties of the office as directed by the secretary.

The accounting and record-keeping activities may be carried on in the office. Actuarial supervision should generally be secured on the outside. Legal advice will usually be available through the office of the attorney for the governmental unit. It is preferable in carrying out the investment program that much dependence should be placed on the advice of a professional investment counselor, if, indeed, the entire investment program is not turned over to one.

Local retirement systems that operate under the supervision of a control agency, such as a state department of insurance, or of finance, or of investments, are in a much stronger position administratively than those that do not.

It is essential to effective management that the board not interfere, other than for purposes of constructive advice and direction, with the secretary. He should be given a free hand commensurate with the responsibilities placed upon him. If he cannot hold up his end, then a change is in order.

Finances and investments. The administrative and management problems and procedures of retirement systems have been discussed in much detail throughout this paper. The most that should be done in this summarization is to re-emphasize certain factors. This is especially important with regard to those of finance and investment.

One of the criticisms against the actuarial type of retirement systems is the danger in the accumulation of large reserve funds of an ineffective handling of those funds.

Strong legal restrictions as to the investment of funds, provision for bonding those who handle the system's money and accounts, and requirements for periodic audits and other control features will do much to offset the danger.

The public employee who contributes to a retirement system does so with the expectation that he is helping to protect himself and his family against the hazards of old age and, in some systems, of disability. Adequate safeguards should be established to protect his contributions.

The taxpayers contribute, often unknowingly, the public's share to a retirement system to assure a more efficient public service. The taxpayers should be assured that their money is soundly administered for the best interests of the system.

The essential safeguards should be provided largely in the legislation, under which a system operates, as to restrictions, controls, and administrative personnel. Following this, adequate administrative techniques and management methods should be made effective.

Summary. The fundamental basis of any sound retirement system is security. Risks are inherent to a degree in any human endeavor, and the very nature of early public retirement systems made them particularly susceptible to careless administration and possible exploitation. Usually established with great haste and pretty much on the basis of guesswork with little thought given to essential details, it is small wonder that there are in operation a large number of unsound and ineffective systems.

The risks in any retirement system may be negligible if a comparatively few principles and practices are followed. For years these have been preached by many who have been acutely concerned with the unsound status of public retirement systems. Failure of adherence to them by the majority of systems may be attributed to selfishness, near-sightedness, or inertia on the part of those most vitally interested.

From the information received during this survey, supplemented by material offered in the writings of authorities on the subject of retirement systems, a few conclusions may be suggested which are of particular importance to the administration and management of public retirement systems.

A retirement system is an important factor in a public personnel program and therefore should be established or reorganized scientifically, and planned for the long-time future as well as for the present.

The system should be established or reorganized, if possible, on a joint-contributory actuarial reserve basis that will provide for the accumulation of reserves, based on actuarial calculations, from which retirement allowances and other benefits will be paid.

The enabling legislation should be carefully prepared.

The provisions under which the system will operate should be complete in scope and precise in wording, leaving only limited discretionary powers to the administrative board.

The section of the legislation relating to the administrative board should provide, as far as possible, for the highest type of member representation on a nonpartisan basis with overlapping terms of from three to five years; equal representation between government and employees, with the public represented where feasible; and a membership of from three to seven members.

Where possible the details of management should be entrusted to a secretary, either part time or full time. The specialized nature of actuarial retirement systems requires a secretary with high managerial qualifications. The secretary, under the supervision of the board, should be given considerable leeway in managerial activities.

Records of an actuarial and of an accounting nature should be established and maintained under proper supervision. Accurate and complete recorded data are imperative to the successful operation of the system. The bookkeeping and record keeping are appropriately duties of the manager or his staff.

Actuarial assistance will be needed to set up the retirement system. After the system has been established, the services of an actuary are still needed to determine from time to time the condition of the system and to readjust, if necessary, the benefits or the contributions in order to maintain the necessary balance between assets and liabilities. Because of the specialized nature of actuarial practices, this supervision should generally be procured outside the system.

The legal provisions should state the types of eligible securities and the maximum amount that may be invested in each. Expert opinion should be relied upon in determining the investment policy and program. Periodic evaluations of the portfolio are of value.

Legal advice, if not available through the governmental unit, should be procured on the outside.

To insure the system against the probabilities of fraud in disability cases, a panel of practicing physicians should be available for proper medical and mental investigations.

Periodic checks by an actuary, by an outside investment expert, and by an auditor are necessary to determine the status of the system and are effective means of control on the management and the administrative body. These checks are made by central agencies in some states.

The affairs and operations of the system should continually be kept before the public, the members, and government officials through reports, bulletins, and other media. "To a peculiar degree retirement systems demand that public control that can only come from keeping the facts continually in the light."[13]

These principles, with others that are essential to sound retirement systems but which are not specifically applicable to administrative and management techniques, can be of value, if followed, in overcoming the weaknesses, abuses, and failures so frequently associated with public retirement systems.[14]

IV. CONCLUSIONS

From the information collected for this survey and the other material studied, it is obvious that there are altogether too many independent public retirement systems in existence in the United States. The large majority of them are relatively small systems operating under inadequate legislation with inefficient administration and management, and the true financial condition of which is unknown.

These are unpleasant facts to be faced by those who are interested in raising the standard of administration in public service activities. Likewise, the number of present retirement system members who may be unable to receive promised benefits in future years because of the probable

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[13] Lewis Meriam, Principles Governing the Retirement of Public Employees (New York: D. Appleton and Company, 1918), p. 371.

[14] See Appendix XII for Principles of a Sound Retirement System as accepted by the National Education Association.

bankruptcy of several funds should be a matter of concern.

There is, fortunately, a growing interest on the part of government officials and groups of taxpayers in the problems that are confronting many retirement systems. While this interest doubtless is localized at the present time, it is possible that it could be crystallized to the point that would demand a thorough study of the public retirement system situation from the point of view of state units, if not that of the entire United States.

It may be doubted that much can be accomplished toward the individual reorganization along sound lines of many of the present inadequate and virtually insolvent systems. The proper starting point in correcting the entire situation by setting up retirement systems that are adequate for the members and fair to the public would appear to be the establishment of state systems. The experiences of states that have been successful in this regard are indicative of its possibilities.

Many systems should be absorbed by a state system, or provided, through state agencies, with control and supervision to insure their soundness and effectiveness. Uniformity in retirement system legislation, provisions, administrative procedures, and management practices could be developed to the advantage of local as well as state-wide systems.

Reciprocal relations between state retirement systems and/or local units which would make provision for the transfer, without loss of standing, of public employees from one jurisdiction to another would be valuable in furthering the development of public service employment.

The matter of setting forth standards for public retirement systems is not a difficult one. The difficulty arises when an attempt is made to draft a model system that would be applicable to the several sizes of governmental units and employee groups.

With effective standards in mind, public retirement systems should be established, or reorganized, to promote governmental efficiency, on the one hand, and to give consideration, on the other, to constructive social policy. Finally, in the words of an outstanding authority, an adequate retirement system

> . . . is one that fulfills the requirement of that branch of the public service to which it applies and is at the same time fair to the employees as a class, to the individual members, satisfactory to a public appreciative of the potential social utility of such a system, and financially sound.[15]

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[15] Meriam, _op_. _cit_., p. 385.

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APPENDICES

APPENDIX I

QUESTIONNAIRE FOR THE STUDY OF PROBLEMS OF ADMINISTRATION AND MANAGEMENT OF PUBLIC RETIREMENT SYSTEMS

Name of administrative unit

(City, State, County, School District) ____________________

Title of retirement system ________________________________

Year established _____ Type of employees included __________

<u>General Administration of the System</u>

Title of administrative board or body ______________________

Number of members: ex officio ________ employee representatives ______________ public representatives __________________

What is authority for appointment of ex officio members ______

____

Who elects or appoints public representatives _______________

Who elects or appoints employees' representatives ___________

If board members are paid, how much _____ How often does board meet ___________ Length of term of members ________________

In general what are the more important duties of the board ___

____

Is there a more effective method of administration than by a board ____

<u>Financial Management of the Retirement System</u>

Who authorizes the investment of funds _____________________

Who supervises the investment of funds ________________________

Who makes the fund disbursements ____________________________

Who supervises the collection of members' contributions _______

____

How are members' contributions collected: pay roll deductions ________ members' remittances______other (please specify)____

If an audit is required by law, how often _____ If not required by law, how often are accounts audited ____________________

Who conducts audit: member of the staff ______ a public official _______ a private firm _____ What is the cost _______

Management of the Retirement System

Title of manager of system _________________________________

If a part-time position, what other position does he hold _____

____

Annual salary if full time __________ Annual salary charged to system if part time ____

Classification and number of employees on manager's staff:

assistant manager ______auditors _________ bookkeepers_______

stenographers _________ clerks _____ actuary ________________

investment ____________ other (please specify) _____________

Operating cost of system last fiscal year ___________________

Who pays operating cost: gov't agency ___________ employees ____________________ both ___________________________________

<u>Investment Program and Experience</u>

Are investments restricted by law _______ If so, to what in general ____

If not restriced, what are the principal types of investment

____

Amount of funds invested _________ Book value of investments

____

Current market value _____________ Amount of assumed interest _________ Can board change amount of interest ______________

Rate of interest earned last fiscal year ______ Average rate of interest earned last five years ________ or, average rate earned since system was started _____ How often are funds made available for investment ______________________________

Who advises on investment of funds: the board __________ the manager_____ a member of the staff_____ professional investment counselor ______ If latter, what is annual cost _______ Does system subscrive to investment services _______________ What is annual cost _________________________________

Is the system under the supervision of the state insurance board _____________

<u>Actuarial Advice and Experience</u>

Is the system on an actuarial reserve basis ________ If actuarial examination is required by law, how often ___________________

If not so required, how often does actuary examine ____________ Does the manager or staff members have actuarial experience ___

Operation Statistics

How many employees are participating in the system __________

Is participation compulsory or optional ____________________

How many received benefits last fiscal year ________________

How much paid in benefits last fiscal year ________________

Total amount of income last fiscal year ____________ from general fund __________ from special levy ____________ from members _______________ from interest ____________ from sale or maturity of securities ________________________ from other sources (please specify)____________________________________

Relation With Public and With Members

Is an annual report of operation available to the public _____ to members ________ Are any significant procedures used to inform the public and the members as to the operation and status of the system (please specify) ______________________

General Information and Remarks

In case of application by employee for disability retirement, is a panel of physicians retained for physical examination

____

How many physicians examine each such applicant ____________

What fees are paid to these physicians ___________________

Are the present benefits too generous, and, if so, why _____

____

Should the present system by modified, and, if so, how ______

____

What qualifications of training are most essential in the manager: (Please indicate order of importance from 1 to 5; one being most important and five being least important) accounting _____ investment _____ actuarial _____ personnel and office management _________ general administration _____

Remarks and recommendations ______________________________

____

____

Data reported is for the fiscal year ending ____________

Date of this report ________________________________

Name, title, and address of person reporting ____________

____

APPENDIX II

STATEMENTS FROM RETIREMENT SYSTEM MANAGERS

I. The three Plans are grossly insolvent, and have been almost from the inception of the Plans. As a matter of fact, both of these Plans were very largely political set-ups, the same as is to be found in so many cities, with entirely too early retirement privileges, as well as too liberal pension allowances. As a matter of fact, both of these funds started off with the employee contributing but 1 per cent of his salary, and under the scale of benefits provided, it was necessary to be about 25 per cent or 30 per cent in order to make the Plan actuarially solvent. At the present time the (A) fund has assets of approximately $121,429, with actuarial liabilities of probably two million dollars or more. The (B) plan has no assets whatever, with present actuarial liabilities of approximately the same amount as the (A) Plan. In the case of the (B) Plan, the City has a general obligation under the law to service the Plan. That is not true with the (A) Plan, nor with the general group, or third Plan. At the present time the general group, or third Plan, has assets of approximately $182,718.76, with acturial liabilities of several hundred thousands, but nothing so serious as in the case of the Fire and Police. As a matter of fact, the general group, or third Plan, under the law, will, in time, work itself out so as to put it on a sound basis.

A year ago those of us who were interested in getting a sane and solvent retirement plan developed what we then believed to be as good a pension plan as was to be found anywhere. We presented it to the Legislature with the result that the politicians and selfish City employees beat us to the draw and we got nowhere.

II. We are practically in forced liquidation. In 1923 we had assets of $100,000 and in 1933 they were $512,000. During those years the men to go on pension numbered about ten and deaths of old pensioners were about five, so that the increase was about five a year--this was taken up by new members. Our pension payroll in 1933 amounted to about $4,300 a month. Soon after the newly elected Mayor came into office he forced sixty-five of the older employees on pensions, thereby increasing our monthly pension roll to over $11,000. The Fund has been meeting this increase ever since by SELLING OUR ASSETS--mostly mortgages--and today our assets are about

$110,000, including property about $55,000 which we had to take over. Our monthly receipts are now about $6,000 leaving a monthly deficit in the pension payroll of about $6,000. When the $110,000 of assets is entirely liquidated the City under the law has to meet the deficit.

III. We cannot be of much help to you except to hope that you will profit by our mistakes. Our system was organized without any thought as to what might happen in the future. The contributions of the members was 1 per cent until 1927 when it became 2 per cent. The City contributed 2¢ on each $100 valuation. The authorities who were formerly in charge admit the inadequacy of the Fund was realized in 1921 but they did nothing about it. The City Charter does not give the council authority to vote any additional funds. We are going to ask the people to vote for payment of a pension out of the general fund to the present beneficiaries. Then we are going to set up an actuarially sound system for our present men in service.

IV. Under this system the members contribute only 1 per cent of their salaries and the City pays the rest. Benefits consist of disability retirement at any time for injury incurred in line of duty or, after five years of service, for ordinary disability not incurred in line of duty, and for voluntary retirement after twenty-two years service and age fifty, pension in all cases being one-half of last month's salary received, paid monthly for life, with pension to widow of $30 per month and to each child under sixteen years of age $8.00.

The experience of this old pension fund showed an annual expense for fire pensions of about $30,000 in 1922 which had increased to about $60,000 in 1932, with every indication that it would again double during the next ten years.

V. This commission is operated by state law, and not on an actuarial basis, and you will note that we are going in the red every year. The City is compelled by state law to make up the deficit.

VI. The experience of . . . in providing pension benefits for its public employees is similar to that of many other large cities. Policemen and firemen pioneered in the organization of voluntary associations to provide pensions for their own members. The very nature of the work of the two groups of employees made inevitable their early interest in retirement and disability allowances. At first the benefits offered were quite limited. Membership in the association was voluntary and involved only a small employee contribution. The public contribution was negligible and little public interest was recognized in the control of the association.

As members became eligible for benefits the inadequacy of the existing funds became apparent. The cost of even the limited benefits had greatly been underestimated. Another organization was then formed, membership was made compulsory and the contributions of both employees and public were increased. Benefits were expanded. But neither contributions or benefits or required retirements were placed on an orderly basis.

From the financial standpoint the retirement system has been unsound since inception. It has largely ignored its liabilities until actual payments have become due. It has disregarded actuarial principles.

Proposals have been made for solving the financial unsoundness. Most of them have come from the members and have been in the nature of demands for greater public contributions, and there has been a steady resistance to the application of actuarial principles.

APPENDIX III

RETIREMENT SYSTEMS AND PENSION FUNDS ACCORDING TO THE TYPE OF MEMBERS, AGE OF THE SYSTEM, NUMBER OF MEMBERS, COMPOSITION OF THE ADMINISTRATIVE BOARD, AND THE TERM OF OFFICE OF THE BOARD MEMBERS.

1. The first column shows the type of system. The abbreviations are: police, P; firemen, F; teachers, T; police and firemen, PF; general employees, G; all employees, A.

2. The second column shows the age of the system according to years as of June, 1940.

3. The third column shows the number of members of the system.

4. The fourth column shows the number of ex officio board members.

5. The fifth column shows the number of employee board members.

6. The sixth column shows the number of public board members.

7. The seventh column shows the total number of board members.

8. The eighth column shows the term of office in years.

9. The systems are classified according to population groups.

10. The letters following the number of board members in columns four, five, and six indicate the method of appointment or election to the administrative board:
    - (m) appointed by mayor
    - (g) appointed by governor
    - (b) elected by other board members
    - (e) elected by board of education
    - (c) elected by contributing members of system
    - (s) elected by legislative body of government
    - (v) elected by voters of government unit.

Ex-officio membership is provided for by the legislation unless otherwise noted.

Employee members are elected by their fellow employees unless otherwise noted.

		Members		Board members			
		in the					
Type	Age	system	Ex-officio	Employee	Public	Total	Term
Cities of over 500,000 population							
G	14	11,000	1	2	2m	5	4
PF	39	2,042	3	0	0	3	4
A	17	13,912	1	1b	1m	3	3
T	44	13,292	1e	6	2e	9	3
G	18	15,000	2	3	0	5	3
P	18	6,700	1	3	3m	7	3
P	60	1,354	2b	2	2s	6	1
T	45	7,500	3	3	2e	8	3
G	3	13,770	3	5	1m	9	6
P	22	3,652	5	0	0	5	?
F	?	1,695	5	0	0	5	?
G	2	12,000	1	1	1s	3	3
G	3	5,840	0	2	3m	5	5
PF	22	4,350	0	0	5m	5	5
P	6	760	4	1	0	5	2
T	3	13,584	1	9	3e	13	3
T	?	2,611	1	4	4b	9	2
G	2	1,150	1	3	3s	7	3
F	?	794	1	3	1m	5	3
T	23	38,448	2	3	2m	7	3
G	25	8,500	3	0	2s	5	1
P	53	4,400	?	?	?	?	1
G	25	2,428	3	2	0	5	4
A	18	12,500	2	3	2m	7	5
Cities of 200,000 to 500,000 population							
P	16	450	2	3	0	5	3
F	?	330	2	3	0	5	3
G	?	2,400	3	0	0	3	3
T	30	1,963	1	5	3e	9	6
A	9	4,600	4	3	0	7	6
G	20	4,750	3	2	0	5	2
T	31	3,888	4	5	0	9	2
T	31	1,131	?	?	?	?	?
T	28	1,494	3	9	0	12	3
A	15	3,817	3	0	2s	5	4
F	58	400	0	40	0	40	1
P	37	?	3	5b	0	8	5
PF	21	451	5	0	2m	7	?
P	31	540	4	3	0	7	2
F	50	186	2b	2	2s	6	1
P	?	?	2	2	2b	6	1
P	35	495	3	5	0	8	5
A	25	?	2	3	0	5	3

Type	Age	Members in the system	Board members Ex-officio	Employee	Public	Total	Term
			State-wide Systems				
T	3	9,000	4	0	3c	7	4
T	23	9,600	3	2	0	5	4
T	4	14,401	4	3	0	7	3
T	13	6,000	3	2	0	5	4
T	26	20,817	1	1	1b	3	3
T	25	28,000	1	0	5g	6	5
T	3	5,000	3	0	2e	5	2
T	21	29,000	2g	3	1g	6	3
T	19	48,311	3	3	1g	7	3
T	21	81,000	2	3	2gb	7	?
T	3	4,616	2	3	2g	7	5
T	21	540	3	2	0	5	2
T	2	14,000	2	3e	0	5	3
T	18	35,000	1	1g	3g	5	6
T	1	17,000	3	3	1c	7	4
T	2	329	3	2	0	5	2
A	8	30,882	3	3	2g	8	4
G	3	349	3s	2	0	5	3
A	9	5,668	3	6	0	9	3
A	11	11,600	3	4	0	7	4
G	6	60,000	0	4	3?	7	2
G	18	9,592	1	4	2g	7	3
G	19	89,520	0	0	0	0	0
			Cities 100,000 to 200,000 population				
F	6	38	3	2	2m	7	4
T	4	900	2	4	1b	7	6
T	30	810	1	5	3e	9	3
P	37	114	3	5	0	8	3
G	3	475	1	1	1m	3	3
G	1	800	2ms	2	3b	7	3
A	3	1,980	5	0	0	5	2
A	1	?	2	3	2s	7	2
T	1	1,000	?	?	?	?	3
P	14	161	1	4	4mc	9	1
G	13	900	2	4	2s	7	5
F	33	119	3	5	0	8	4
G	3	943	1	1	1m	3	3
T	29	?	4	3	0	7	3
A	16	1,148	1	1	1b	3	4
PF	5	177	3m	6	0	9	2
PF	33	586	6	0	0	6	2
F	26	228	3m	2	0	5	2

Type	Age	Members in the system	Board members Ex-officio	Employee	Public	Total	Term
			Cities 100,000 to 200,000 population (continued)				
P	32	125	1	2	2m	5	2
P	2	160	2	2	0	4	1
G	7	1,060	1	6	0	7	2
G	3	450	1	1	1s	3	?
P	17	250	?	?	?	?	?
F	25	275	1	1	1s	3	?
			Cities of 30,000 to 100,000 population				
A	1	168	3	1s	1s	5	2
PF	20	200	2	2	1b	5	1
PF	3	115	2	2	1b	5	?
A	3	261	1	1	1m	3	3
A	6	318	1s	1s	1s	3	3
A	8	183	1	1m	1m	3	3
T	10	333	0	0	7v	7	3
PF	25	250	2	2	1b	5	4
A	9	256	1s	1	1m	3	3
PF	2	163	5	0	0	5	2
A	3	403	1	1	1m	3	3
PF	19	?	2	2	1b	5	2
PF	20	182	2	2	1b	5	2
P	20	58	2	2	2b	6	1
T	25	?	3	6	0	9	4
PF	20	?	2	4	0	6	1
T	26	397	5	5	0	10	?
F	?	?	2	3	0	5	3
A	?	?	1	1s	1s	3	3
PF	5	210	1s	2	2s	5	4
PF	19	117	2	2	1b	5	2
P	3	89	4	3	0	7	1
PF	23	110	3	1	0	4	2
F	32	63	4	3	0	7	1
PF	30	83	1	1	2m	4	2
A	5	975	3	2	2s	7	4
PF	26	176	2	0	1b	3	?
G	3	250	1	1	1m	3	3
G	3	134	1	1	1m	3	3
PF	20	150	2	2	1m	5	2
G	5	379	1	1m	1m	3	3

Type	Age	Members in the system	Board members Ex-officio	Employee	Public	Total	Term
			Cities of 10,000 to 30,000 population				
T	13	98	0	0	0	6	?
A	3	124	1	1	1s	3	3
A	3	74	1	1	1s	3	3
A	3	79	1	1	1s	3	3
A	3	146	1s	1	1m	3	3
T	36	78	2	3	4e	9	1
P	8	?	3	2	0	5	2
A	3	128	1s	1	1m	3	3
A	3	161	1	1	1m	3	3
A	3	201	0	1	2s	3	3
T	7	195	1	2	4s	7	2
A	2	180	1	4m	3m	8	7
A	3	125	3	2	0	5	?
A	3	183	1	1	1s	3	3

APPENDIX IV

RETIREMENT BOARD FUNCTIONS AND RESPONSIBILITIES*

a. To receive and expend any monies contributed by employees or appropriated by the State, or the Board of Control, as provided in the Act.

b. To invest and re-invest the pension fund in investments legal for the funds of life insurance companies.

c. To determine, subject to judicial review, the eligibility of employees and the rights of any individual coming under the Act.

d. To hire and dismiss any employees necessary for the proper administration of the Act, and to engage expert actuarial auditing and medical advice whenever in the judgment of the pension board it is necessary.

e. To maintain adequate actuarial and accounting practices and appropriate accounts and funds including:

   (1) Accounts and funds showing the contributions of each employee and their accumulation with interest.

   (2) Separate accounts and funds showing the contributions by the State and their accumulations with interest.

   (3) Separate accounts and funds showing the several accrued and accruing liabilities of the State under the Act, including its accrued liability on account of service rendered prior to the effective date of this Act by employees who shall participate in the pension system.

   (4) An account of its liabilities accruing in connection with the service rendered after the effective date of this Act by employees who shall participate in the pension system.

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*State of Connecticut Public Document No. 88, Report of Commission appointed to study Pension Systems in the State of Connecticut, 1937, p. 10.

APPENDIX V

TITLES OF ADMINISTRATIVE BOARDS

Board of Trustees	34
Contributory Retirement Board	7
Board of Directors	5
Pension Commission	4
Pension Committee	3
Pension Fund Board	
Board of Retirement Commissioners	2
Annuity and Investment Board	
Trustees of Pension Fund	
Civil Service and Pension Board	
Board of Control	
Pension Trustees	
Retirement Board	33
Pension Board	7
Board of Retirement	4
Board of Administration	3
Board of Pensions	2
Pension Fund Commission	
Retirement Fund Board	2
Board of Pension Commissioners	
Annuity and Pension Board	
Trustees of Relief Fund	
Relief Fund	
Personnel Advisory Board	
Retirement System Board	

Note: Figures following each title indicates the number of retirement systems using that title.

APPENDIX VI

LEGISLATIVE PROVISIONS FOR ADMINISTRATIVE BODIES

Excerpts from the enabling legislation of three retirement systems are given here as examples of the manner in which administrative bodies are provided.

> The general administration and management of the retirement system, and the responsibility for its proper operation and for making effective the provisions of this Act are hereby vested in a Board of Trustees, which shall be known as the Board of Trustees of the Teachers' Retirement System of the State of Kentucky. The members of the Board of Trustees shall be the Superintendent of Public Instruction, the Attorney-General, and the State Treasurer, ex-officio, and four other members of the retirement system, hereinafter known as teacher members, and one of whom shall be a person who is not a member of the teaching profession, hereinafter known as the lay member, provided that the first Board of Trustees elected after the enactment of this Act shall consist of the above named ex-officio members; and four other members, three of whom shall be teachers as defined in this Act, and one of whom shall be a person who is not a member of the teaching profession.
>
> State Teachers Retirement System,
> Kentucky

> The Board of Trustees of the Policemen's Pension Fund shall consist of six (6) members, who shall be chosen in the following manner: Two members shall be chosen by the City Council from its own members. Two members shall be elected by the members of the Police Department. Two other members shall be residents of the City of Lima, Ohio, and not members of the City Council or the Police Department, one of whom shall be chosen by the two members chosen by the City Council, and one shall be chosen by the two members elected by the Police Department. In the event of a tie vote on any matter whatsoever, the six (6) members so chosen shall choose a seventh member whose vote shall decide the question.
>
> Police's Pension Fund, Lima, Ohio

This board shall be known as the Trustees of the Police Relief Fund, and shall be composed of two members elected by Council, two members elected by the Police Department, and two members chosen, one by the two members elected by Council, and one by the two members elected by the Police Department.

Police Relief Fund, Toledo, Ohio

APPENDIX VII

ESSENTIAL RECORDS FOR ACTUARIAL RETIREMENT SYSTEMS
(Suggested in Retirement Systems for Public Employees, published by Municipal Finance Officers Association, 1938, p. 8)

Fundamental records necessary to set up and operate a retirement system are discussed below. The Enrollment Blank is prepared by the employee in triplicate before becoming a member of the system. The member's beneficiary is designed on the reverse side. The triplicate copy is retained by the employee and the first two copies are turned in to the Retirement Board. As soon as an employee is enrolled as a member, he should be entered on the Active Service Register. When a member leaves the service, an entry should be made on the Withdrawal Register. When a member retires, an entry should be made on the Retirement Register, and when an allowance is discontinued, an entry should be made on the Termination Register. Each register shows the "date," "name," and "number." Entries are numbered consecutively so that a number automatically is assigned to each entry. The last number in the Withdrawal Register, subtracted from the last number in the Active Service Register, gives the number of active members to be accounted for. Other combinations of register numbers furnish control figures as to entrances and exits during any period for which data is required for actuarial or accounting purposes. An Alphabetical Index Card showing the name, address, and various register numbers assigned should be maintained for every member as a convenient cross-reference. Where a system includes a large number of members, visible files can be used economically for this purpose.

An Active Service History Record should be prepared for each member. This record is placed in a loose-leaf file by active register number. Salary deductions for a member's contributions can be accumulated on an Annuity Savings Card and posted at the end of each year from the latter to the reverse side of the Active Service History Record. The number entered on the Annuity Savings Card is the active register number. To facilitate entries for salary deductions, the cards should be filed alphabetically within a departmental grouping or in any other order in which payroll transcripts are received. A municipality with a large number of participants can save time and effort and assure greater accuracy by posting members' contributions by machine.

A Retired Member History Record should be prepared for each member who retires. This record is placed in a loose-leaf file by retirement register number. Many systems require that the secretary send a report to the actuary concerning each person to be retired and that the actuary certify the amount of reserve to be transferred from the various funds. At the end of each year the amount of retirement allowance paid during that year is posted to the reverse side of the Retired Member History Record.

To keep costs from becoming excessive, every precaution should be taken to prevent fraud. Retirement allowances are based on life expectancy. To prevent payments after a beneficiary's death, the procedure described below can be used. When a retirement or other benefit is first granted, the beneficiary should be required to sign a Signature Card in the presence of an official who can identify the person. The cards are filed alphabetically. When the first monthly check is mailed to the beneficiary, a Voucher should be enclosed in the same envelope. For example, when the October check is mailed the November Voucher is enclosed. One month later, and not earlier, the voucher must be signed, witnessed and returned. The signature on the voucher then is compared with the Signature Card and the November check mailed with the December Voucher. Instead of the form illustrated, some municipalities use a postcard which is mailed with the check to be signed and returned monthly by the beneficiary. An additional precaution is to compare the check endorsement with the Signature Card.

APPENDIX VIII

EXAMPLES OF LEGAL PROVISIONS FOR THE INVESTMENT OF THE FUNDS OF RETIREMENT SYSTEMS

"The moneys of the pension fund shall be invested by the Treasurer and Controller when and in the manner authorized by the Board of Pensions." Article 9, Section 1, _Rules and Regulations of the Pension Fund_, Philadelphia, Pennsylvania.

". . . the Board of Trustees is empowered to invest such excess funds in United States, Georgia, or municipal bonds; but not otherwise." Article 4, Section 2, of the _Firemens' Pension Act_, Atlanta, Georgia.

"The Board of Trustees . . . shall have full power to invest and reinvest such funds in bonds, secured by the faith and credit of the United States, or in coin or treasury notes of the United States, or in interest-paying or dividend-paying bonds or stocks secured by the faith and credit of this State or of any other state of the Union, or of Baltimore City, or of any of the several counties of this State, having legal authority to issue the same, and not in default; . . ." Ordinance 390 (1932-1933) applying to _Employees' Retirement System_, Baltimore, Maryland.

"The Board of Trustees . . . shall have full power to invest and reinvest such funds subject to all terms, conditions, limitations, and restrictions imposed by the law of Michigan upon life insurance companies in the making and disposing of their investments, except that notes, bonds, or obligations of the City of Detroit shall not be subject to said restrictions or limitations. The Board of Trustees shall have the power to purchase notes, bonds, or obligations of the City of Detroit before or after same are offered to the public and with or without advertising for bids." City Charter, Chapter VI, Title IX, Article VIII, Section 1, applying to _Retirement System_, Detroit, Michigan.

". . . Investments shall be made only in securities in which the trustees of a savings bank may invest the moneys deposited therein as provided by law." Section 1107, Education Law, _State Teachers' Retirement Fund_, New York.

". . . The funds of the Association shall be invested only in:

1. Bonds of the United States Government.
2. Bonds which are guaranteed as to principal and interest by the United States Government.
3. Bonds issued under the 'Federal Farm Loan Act.'
4. Bonds of the State of Minnesota, or bonds which are the direct obligation of any county, school district, or other municipality in said State.
5. Bonds which are the direct obligation of any State of the United States other than the State of Minnesota, provided, however, that the total investments of the Association at any one time in bonds of any one state other than the State Minnesota shall never exceed $25,000 par value.
6. Bonds which are the direct obligation of any county, school district, or other municipality in any State of the United States other than the State of Minnesota, provided, however, that the total investments of the Association at any one time in such bonds of any one county, school district, or other municipality of any other state than the State of Minnesota shall never exceed $10,000 par value.
7. Warrants issued by the Board of Education of the City of Duluth.
8. Securities other than those above described which constitute legal investments for saving banks in any three of the States of Connecticut, Massachusetts, Minnesota, New York, and Pennsylvania; provided, however, that the total investments of the Association at any one time in any one such security shall never exceed $5,000 par value; and provided further that the total amount of all such investments shall never exceed 10% of the total assets of the Association.
9. First mortgage loans upon improved business or residence property in the City of Duluth, Minnesota, where the amount of any such first mortgage loan does not exceed 40% of the appraised value of the mortgaged property . . ." Article VI, Articles of Incorporation, Teachers' Retirement Fund, Duluth, Minnesota.

APPENDIX IX

STATEMENT OF SECRETARIAL DUTIES*

"In addition to the officers provided for in the Articles of Incorporation, there shall be appointed by the Board of Trustees an executive secretary not a member of the Board of Trustees whose duties shall be as follows: Such executive secretary shall keep full and accurate account of the business transactions of this Association; shall keep an account with each member of the Association; shall attend to the collection of all income, including members' deposits and city deposits and the depositing of the same with the treasurer; shall prepare all warrants for the payment of any money and countersign the same, and shall have entire charge, under the supervision of the other officers of the Association, of the books of account and the collection and disbursement of the funds of this Association; shall act as assistant to the secretary in writing up the records of the meetings, in sending out any notices that may be required to be sent out by the secretary . . . "

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* Article VI of the By-Laws, Minneapolis Teachers' Retirement Fund Association, Minneapolis, Minnesota.

APPENDIX X

PROVISIONS FOR MEDICAL EXAMINATIONS

"By acceptance of membership in and the payment of contributions to the Retirement Plan, each member, in the event of actual or alleged disability or sickness upon which claim for benefits may be made at any time, agrees to submit, at all reasonable times and places during the continuation of said disability or sickness, to physical examination by one or more physicians or surgeons designated by the Board, and authorizes all attending physicians, surgeons, and hospitals to exhibit all of their records and histories pertaining to any disability or sickness upon which claim is or may be based or to furnish copies thereof to the Board on demand, all such examinations to be at the expense of the Disability Fund. Said examinations and records shall be secured whenever necessary in the normal conduct of business by and the proper administration of claims against the Disability Fund. Such an examination shall be made immediately preceding the allowance of any claim for permanent total disability benefits. whenever in its judgment such re-examination is advisable or necessary. Reports in writing in the form determined by the Board shall be made by attending physicians and surgeons when and as ordered by the Board." Section V, page 30, _Water and Power Employees' Retirement, Disability, and Death Benefit Insurance Plan_, Los Angeles, California.

APPENDIX XI

OBJECTIVES OF, AND PROPOSALS FOR, THE EXTENSION OF FEDERAL INSURANCE COVERAGE TO STATE AND MUNICIPAL EMPLOYEES

Objectives

I. To provide continuity of protection for those employees who transfer from one employment to another during their working lifetime. Transfers may be from one municipal employment to another, or from municipal employment to a covered occupation, or vice versa. Such protection should be distinguished from a cash return of contributions under any retirement system.

II. To provide at least a "floor of protection" for approximately one and a half million State and municipal employees who are not now covered by any retirement or insurance system.

III. To provide monthly benefit survivors protection for 80 per cent of those who are members of a retirement system. Only about 20 per cent are now members of systems which have adequate survivorship protection.

IV. To avoid any reduction in existing protection, such as old age benefits or disability benefits, as provided by existing systems. This assumes that existing benefits are on a reasonable scale and soundly financed. Otherwise some modification in existing benefits is to be expected.

V. To prevent unnecessary duplication of protection in two or more systems and to close up the gaps between systems so that there will be no individuals without some adequate protection.

To meet these objectives the following major plans have been proposed.

A. Wagner Bill. This would provide compulsory coverage for all State and municipal employees regardless of existing retirement systems. With such coverage, existing plans should be so modified that they would continue as supplemental retirement systems, in general, providing in conjunction with the Federal insurance coverage as much or more old age protection as the systems now have. It also contemplates the formation of the additional supplementary systems. This plan would accomplish the first three major objectives.

B. Wagner Bill as amended. This would provide compulsory coverage for all State and municipal employees who are not now members of an existing system. It contemplates no possibility of supplementing the Federal system with special public systems. This plan would accomplish only the second major objective.

C. Voluntary compacts. This plan would extend coverage by voluntary agreements between the Federal insurance systems and States or minor political units. It would provide coverage only for such limited groups as defined by the voluntary election of individual States or minor political units. It contemplates the possible coverage of members of existing systems and the revision of these systems to make them supplementary to the Federal insurance program. It also contemplates the possibility of the formation of new supplementary retirement systems. This plan would accomplish the first three major objectives only to the limited extent that the State or other units elected to enter the Federal system.*

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* Summary of Proceedings, Informal Conference on Extension of Old Age and Survivors Insurance under the Federal Social Security Act to State and Local Employees, Washington, D.C., November 25, 1940. Sponsored by Municipal Finance Officers Association.

APPENDIX XII

PRINCIPLES OF A SOUND RETIREMENT SYSTEM

(Developed by Committee on Retirement Allowances of the National Education Association)

(1) Membership should be compulsory for teachers entering the service after the enactment of the retirement law; optional for teachers already in service.

(2) Retirement ages and rules should be defined and administered so as to retain teachers during efficient service and provide their retirement when old age or disability makes satisfactory service no longer possible. The retirement allowance should be sufficient to enable the retiring teacher to live in reasonable comfort, thereby removing the temptation to remain in the classroom beyond the period of efficient service.

(3) The sums deposited by teachers and by the public during the period of service should be approximately equal.

(4) The deposit by the teacher and the payment by the public should be stated by the organic act creating a retirement system subject to adjustment in accordance with future actuarial investigation.

(5) Deposits to the account of each teacher should be made by the teacher and by the state regularly and concurrently during the period of service.

(6) The retirement board should open an account with each individual teacher. Sums deposited in that account by the teacher should be held in trust for that teacher.

(7) An adequate and actuarially sound reserve fund should be created so that the teacher may be guaranteed that the necessary money to pay the benefits promised is actually on hand at the time of retirement.

(8) Periodic investigations by actuaries should be made of every retirement system to insure its financial soundness.

(9) A retirement allowance should be provided for disabled teachers after a reasonable period of service.

(10) Teachers leaving the service before the regular retirement age should retain rights to all moneys accumulated in their accounts (their deposits). Teachers' deposits should be returnable upon withdrawal from teaching service, or death prior to retirement.

(11) The teacher should have the opportunity to elect the manner in which he will receive the benefits represented by the accumulated value of his deposits and the state's payments.

(12) Upon the adoption of a retirement plan, teachers should be given credit for their service prior to the establishment of the system. Funds for this purpose should be provided by the public.

(13) The public should guarantee active teachers all the benefits which they had a reasonable right to expect under the old system. It should guarantee teachers retired under a previous system the allowance promised at the time of their retirement.

(14) Provisions should be made for cooperative or reciprocal relations between the retirement systems of the different states.

(15) The board in charge of the administration of the retirement system should represent both the public and the teachers.

(16) The make-up of the retirement board should be so prescribed as to assure a high type of representatives for both the public and the teachers.*

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* National Education Association, Research Bulletin No. 8, November, 1930, p. 225.