COSTS AND BENEFITS OF THE TEACHER PENSION SYSTEM IN MASSACHUSETTS

Answers to Frequently Asked Questions

MTA
Massachusetts Teachers Association

Introduction

There's a powerful myth in Massachusetts that public employee pensions are excessive and must be cut in order to save the state from bankruptcy. This is simply untrue. In the past, there were some loopholes in the pension system that led to a small number of highly publicized abuses – none involving teachers. The Legislature and governor passed a bill in 2009 to end those abuses. That was good public policy.

The governor subsequently appointed a Special Commission to Study the Massachusetts Contributory Retirement Systems that published a background study in September 2009. Many of the facts and figures in this FAQ are from that study.

The background paper scrupulously documents the little-known fact that public employees in Massachusetts hired after July 1, 1996, pay the vast majority of the costs of their own pensions; the taxpayers pay very little. In fact, taxpayers pay a minimum of $220 million a year less than they would legally be required to pay if those employees received the same benefits as private sector workers and participated in the Social Security retirement system.

As the Special Commission study explained, "[T]he public often fails to recognize that public employees are not covered by Social Security and make substantial contributions to their own benefits." The commission strongly recommended against switching from the current "defined benefit" system (one in which retirement income is guaranteed for life) to a "defined contribution" system (one in which a guaranteed amount of money is paid into the system each year). "The commission agreed from the outset that, as a matter of fiscal policy, Massachusetts should continue to oppose Social Security coverage of its employees," the report noted. "It is absolutely clear that *for a given level of protection* a defined benefit plan is cheaper."

This booklet specifically looks at the costs and benefits of the Massachusetts Teachers' Retirement System. However, that system is very similar to those under which state and municipal retirees – including MTA's higher education members and Educational Support Professionals – are compensated. The bottom line is the same: Public employees in all education sectors in Massachusetts are paying the bulk of the costs of their own retirement benefits, and taxpayers are getting a bargain.

FAQ on Teacher Pensions in Massachusetts

How does the retirement system work in Massachusetts for public school teachers and administrators (referred to in this document as "teachers")?

Teachers are enrolled in the Massachusetts Teachers Retirement System (MTRS) and become vested after 10 years.[1] Like other public employees in the state, they are not allowed to participate in the federal Social Security retirement, disability and survivor system while employed in the public sector; therefore, those who have only worked in the public sector receive no Social Security retirement benefits.[2] Those who worked in the private sector for at least 40 quarters receive only limited Social Security retirement benefits.

In addition to retirement benefits, MTRS provides members with disability and survivor benefits. In essence, it is their Social Security. Currently, the MTRS serves 88,000 active educators and 54,000 retirees.

The MTRS pension system is what is called a "defined benefit" plan.

What is a defined benefit plan?

A defined benefit plan is a type of pension plan in which an employer promises a specified monthly benefit on retirement that is predetermined by a formula based on the employee's earnings history, tenure of service and age.

Under the MTRS, a teacher's retirement benefit is determined according to a set formula, and the amount is guaranteed regardless of fluctuations in the pension fund's performance. Members' benefits are payable

---

1 Although all teachers are vested after 10 years of service, only those over age 55 are eligible to begin collecting retirement benefits. Benefits for those working just 10 years would be a small fraction of the maximum allowable benefits. Teachers who have 20 years of service are eligible to collect benefits even if they are under age 55, but, again, the benefits would be greatly reduced since benefits are calculcated based on a combination of both age and years of service. The earliest a teacher could retire with maximum benefits would be age 57 if that teacher has worked full-time, continuously, for 35 years – that is, since age 22.

2 Beginning in 1986, public employees in Massachusetts were required by law to participate in the Medicare portion of the FICA system, so they and their employers each contribute 1.45 percent of their salaries toward this health benefit. However, neither pays anything toward the retirement, survivor and disability benefits portion of FICA (referred to in this FAQ as Social Security retirement benefits), which is 6.2 percent of salary a year paid by each party – employer and employee.

for their lifetimes, or for their survivor's, depending on the retirement option they select. The employees' contributions are established by statute. The employer – the Commonwealth – contributes a variable amount depending on how much is needed to honor pension obligations after taking employee contributions and investment returns into consideration.

Social Security, like the MTRS, is a kind of defined benefit plan. All private sector employers and employees must each pay 6.2 percent of the employee's salary (up to $106,800 in 2010) toward that individual's Social Security retirement benefits. These benefits are guaranteed, regardless of how long the recipient lives or fluctuations in the market. Private sector employees who have participated in the Social Security retirement system for at least 40 quarters receive a defined benefit that is based on the number of years worked and amount of money contributed. Thus, when people say public sector employees are especially fortunate since they receive a defined benefit pension and "nobody" in the private sector does any more, they are not correct.

What is a defined contribution plan?

Under a "defined contribution" plan, retirement benefits are dependent on the contributions made by the employee, and possibly by the employer, and the growth of those assets over time as they are invested in the financial markets. A defined contribution plan is susceptible to fluctuations in the market. No fixed monthly payment is guaranteed, and retirement benefits end when the money runs out.

Roughly half of private employees are covered by an employer-sponsored defined contribution retirement plan in addition to Social Security. Nearly two-thirds of employees with coverage participate in a 401(k) retirement plan, where typically employees contribute 6 percent of their salaries and employers make a 3 percent matching contribution. The other one-third is covered by a defined benefit plan – a private sector pension – in addition to Social Security, where the employer is often responsible for all or nearly all of the funding.[3]

What are the major advantages of a defined benefit plan?

The most obvious are security and predictability. The Special Commission report states, "Defined benefit plans sponsored by perpetual entities such as state and local governments provide a more secure retirement for long-tenured employees than defined contribution plans." Although teachers are paying most of the costs of their own retirement, the employer – in this case the Commonwealth – accepts greater risks. If investment returns do not live up to projections, the Commonwealth must make up the difference. Conversely, however, if investment returns outperform projections, the Commonwealth benefits from the savings.

A second advantage is that pension funds are invested by professionals and are less subject to the kinds of mistakes that inexperienced employees often make with their own defined contribution plans.

A third advantage for both employers and employees is that the administrative expenses as a percentage of assets are much lower for defined benefit plans: 0.3 percent compared to 0.9 percent for defined contribution plans.[4]

What are the major advantages of a defined contribution plan?

Portability is the main benefit. Since the contributions are paid directly into individual accounts for each worker, workers may take their accumulated funds with them when they change jobs.

Immediate vesting is another advantage. The employer's contributions to the individual account become the property of the worker upon payment.

Personal control could be an advantage or disadvantage. Plan funds that are invested well may yield higher returns than a pension fund, but the reverse is also true – as so many private sector employees experienced during the recent recession, when their retirement plans lost substantial value.

How are MTRS benefits funded?

MTRS retirement benefits are guaranteed by the Commonwealth. The funding for MTRS benefits comes from three sources:

1. ***Employee contributions:*** Retirement contributions by employees to the MTRS are invested in the state's Pension Reserves Investment Trust Fund.
2. ***Employer contributions:*** The Commonwealth makes an annual appropriation for the payment of its share of public employee retirement benefits. For the purposes of retirement benefits, the Commonwealth is the "employer" for public teachers. Local school district employers do not contribute toward their teachers' retirement benefits.

3 "Background Study for the Special Commission to Study the Massachusetts Contributory Retirement Systems," Sept. 1, 2009, p. 9.

4 "Background Study," Op Cit, p. 4.

3. ***Investment earnings:*** Earnings in the Pension Reserves Investment Trust – which includes the MTRS pension funds – have averaged 9.45 percent since inception (1984).

What is the average teacher pension?

Currently, the average teacher pension is just $38,637.[5] Remember, most teachers receive little or no Social Security retirement benefits, so the pension may be an education retiree's sole source of income in retirement.

Why do some teachers receive no Social Security benefits?

As noted above, in Massachusetts and a few other states teachers and other public employees do not pay into the Social Security retirement system and thus do not accrue Social Security retirement benefits. Their MTRS pensions are meant to take the place of Social Security, not to supplement it.

Teachers and other Massachusetts public employees who worked in the private sector for at least 40 quarters and/or who outlive a spouse who was receiving Social Security benefits may be eligible for some Social Security retirement or spousal benefits. However, those benefits are greatly diminished – in some cases reduced to zero – because of two provisions in federal law: the Government Pension Offset and the Windfall Elimination Protection, or GPO/WEP.

These factors combined explain why many teachers in Massachusetts receive no or limited Social Security retirement benefits.

Are teacher pensions very expensive for taxpayers?

No. Teacher pensions are a bargain for taxpayers, and in fact are much less expensive for taxpayers than if teachers participated in the Social Security System.

Teachers hired since July 1, 1996,[6] and those who participate in RetirementPlus, pay 11 percent of their salaries toward their pensions. At that rate, ***teachers fund 95 percent of the normal costs of their own pensions,*** according to the Special Commission to Study the Massachusetts Contributory Retirement Systems. Local school districts pay nothing – zero – toward teachers' pensions. The state's contribution to pensions of the 11-percenters is about one-half of 1 percent (.6 percent) of the employee's salary.[7]

Teachers hired before 1996 who do not participate in RetirementPlus pay at lower rates, which differ depending on when they were hired. The average rate for all teachers is 9.74 percent, according to the MTRS, which means the state's share of the total normal cost of retirement for all teachers, on average, is slightly less than 2 percent of the teachers' salaries. It bears repeating that is very small employer contribution – much smaller than if teachers were part of the Social Security retirement system.

How much would it cost taxpayers if teachers were treated like private sector employees and participated in Social Secuirty?

Employees would pay less (instead of 11 percent to MTRS, they would pay 6.2 percent to Social Security), and the Commonwealth would pay more (instead of 2 percent, on average, the Commonwealth would pay 6.2 percent to Social Security on behalf of each employee).

According to the MTRS, the Commonwealth is paying $122 million this year toward the normal costs of retirement for MTRS members. If those teachers were instead enrolled in the Social Security retirement system, the Commonwealth would have to pay $342 million – or $220 million more than is currently being paid on their behalf.[8]

Is that the only additional cost?

No. That $220 million is just a start. As noted above, half of all private sector employees receive retirement benefits from their employers in addition to the required Social Security contributions. If the Commonwealth acted like a typical large, private sector company, it would contribute 3 percent of each employee's salary to a 401(k)-style plan, for an additional cost of $165 million a year. Add that to the $220 million in Social Security payments, and the projected increased annual costs of switching to a private sector type of retirement system would be $385 million.

---

5 This figure provided by the MTRS is as of Jan. 1, 2010, based on the most recent data available. It refers to the average "superannuation" pension, meaning it excludes disability and survivor benefits. When those figures are included, the average pension is lower. The retirement benefits for teachers who retire today and who have participated in the MTRS long enough to receive the maximum benefit are above the average, while the benefits for those who retired a long time ago or who didn't work long enough to earn the maximum benefit may be below the average.

6 For those hired between July 1, 1996, and July 1, 2006, the rate paid on the last dollar earned is 11 percent, though the effective rate is closer to 10 percent. Specifically, the rate is 9 percent on the first $30,000 of salary and 2 percent on the portion over $30,000. For those hired after July 1, 2006, the rate is 11 percent on the entire salary.

7 "Background Study," Op Cit, p. 8

8 Data available provided by Sean Neilon, assistant executive director of the MTRS.

How do teachers' contributions toward their own pensions in Massachusetts compare to the contributions of teachers and other public employees elsewhere?

According to the Special Commission report, Massachusetts teachers pay a higher percentage of the normal costs of their pensions than public employees in other states.

Don't teachers at least get a significant cost-of-living adjustment (COLA) on their pensions?

No. While the COLA on Social Security retirement benefits is applied to the entire amount of the pension, a maximum COLA of 3 percent is applied to only the first $12,000 of a public sector retiree's pension in Massachusetts. That means whether a retiree's pension is $12,000 or $40,000, the highest COLA he or she will receive is $360 a year, or about 99 cents per day.

But what about the unfunded pension liability?

In the past, the Commonwealth has incurred an unfunded pension liability for many reasons – including underfunding the pension trust fund in order to fund other budgetary expenditures.

The unfunded liability is a contractual obligation to retirees and employees. Even if changes were made to the pension system reducing payments to retirees in the future, the Commonwealth is legally obligated to maintain pension payments to current and retired employees who participate in the system.[9] Today's public employees did not cause the problem and should not be penalized in order to solve it. As the Special Commission concluded, "In all cases, the burden of amortizing the unfunded liability from past service should be spread broadly among taxpayers and not borne by today's public employees."[10] Fortunately, the Commonwealth has now established an aggressive plan for paying off the unfunded liability.

This FAQ was written by Laura Barrett of MTA's Division of Communications, with assistance from David Danning of MTA's Research Division.

Information about the teachers' pension system is available on the Massachusetts Teachers' Retirement System website at *http://www.mass.gov/mtrs/*

The MTA conducts retirement consultations for individual members throughout the state. The schedule appears in *MTA Today* and online at *http://www.massteacher.org/memberservices/retirement/planning.aspx*. Local presidents who would like to schedule pension workshops for their associations should call Harold Crowley at 800.392.6175 x8240.

9 "Background Study," Op Cit, p. 4.

10 "Background Study," Op Cit, p. 11.