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The Investment Decisionmaking Process in Two New York Public Employee Retirement Plans. B-164292; HRD-77-41. February 16, 1977. 2 pp. + appendices (69 pp.).

Report to Sen. Harrison A. Williams, Jr., Chairman, Senate Committee on Labor and Public Welfare; Sen. Jacob K. Javits, Ranking Minority Member; by Elmer B. Staats, Comptroller General.

Issue Area: Income Security Programs: Programs tc Protect Workers' Income (1306).
Contact: Human Resources Div.
Budget Function: Income Security: General Retirement and Disability Insurance (601).
Organization Concerned: Department of Labor.
Congressional Relevance: Senate Committee on Labor and Public Welfare.
Authority: Administrative Code for the City of New York, title B, chap. 20. New York Laws of 1920, chap. 741. New York State Laws of 1917, chap. 303. Retirement and Social Security Law of New York State. Employee Retirement Income Security Act of 1974.

Information on the investment decisionmaking process of the New York State Employees' Retirement System and the Teachers' Retirement System of the City of New York was obtained from summary data and interviews with cognizant officials. The information obtained was not verified and the adequacy of procedures and practices followed by the plans was not evaluated. Findings/Conclusions: The New York State Employees' Retirement System is the largest of three State-administered retirement plans for employees of the State and local governments. This plan covers about 552,000 active members, compared with the 259,000 members covered by the two other plans. As of March 31, 1975, this plan had about $6.1 billion in assets, compared with $5.6 billion for the other plans. The State comptroller is responsible for the management and operations of the plan, including the investment of plan assets. He draws on a variety of staff resources and outside investment advisors to administer the plan and manage the investment program. The Teachers' Retirement System of the City of New York is the second largest of five retirement plans in the city. As of June 30, 1975, it had over 83,000 active members and assets totaling about $3 billion. The other four plans had about 257,000 active members and assets of about $5 billion. This plan is managed and controlled by a board of trustees. (SC)

00600

REPORT TO THE SENATE COMMITTEE ON LABOR AND PUBLIC WELFARE

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

The Investment Decisionmaking Process In Two New York Public Employee Retirement Plans

This report is the last in a series of seven studies requested by the committee.

It contains case studies on the New York State Employees' Retirement System and the Teachers' Retirement System of the City of New York, giving details of the structure and operations of the plans.

HRD-77-41

16, 1977

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164292

To the Chairman and
Ranking Minority Member
Committee on Labor and
Public Welfare
United States Senate

In response to your June 14, 1976, letter, we made a series of case studies of fiduciary standards and conduct of public employee pension plans maintained by State and local governments in New York, New Jersey, Georgia, Tennessee, Colorado, Michigan, and Virginia.

In New York, we studied the New York State Employees' Retirement System and the Teachers' Retirement System of the City of New York. Case studies of these plans are included as appendixes I and II. Case studies for the other six States were previously provided to you.

Based on discussions with your office, we developed a framework for the case studies to provide the information needed to help the Committee fulfill its statutory obligations to study governmental retirement plans. The Employee Retirement Income Security Act of 1974 directed the Committee to undertake such studies and provided that the results should be reported to the Senate.

It was agreed with your office that we would obtain information on the investment decisionmaking process from summary data and interviews with cognizant officials. We did not verify the information obtained, and we are not commenting on the adequacy of procedures and practices followed by the plans.

The New York State Employees' Retirement System is the largest of three State-administered retirement plans for employees of the State and local governments. This plan covers about 552,000 active members, compared with the 259,000 members covered by the two other plans. As of March 31, 1975, this plan had about $6.1 billion in assets, compared with $5.6 billion for the other plans.

The State comptroller is responsible for the management and operations of the plan, including the investment of plan assets. For management and investment purposes, the plan's assets have been combined with assets of the New York State Policemen's and Firemen's Retirement System and the State public employees' group life insurance plan. The combined assets, referred to as the common retirement fund, totaled about $8.3 billion on March 31, 1976. The comptroller is assisted in managing the common retirement fund by advisory committees established under State law. He draws on a variety of staff resources and outside investment advisors to administer the plan and manage the investment program.

The Teachers' Retirement System of the City of New York is the second largest of five retirement plans in the city. As of June 30, 1975, it had over 83,000 active members and assets totaling about $3 billion. The other four plans had about 257,000 active members and assets of about $5 billion.

This plan, established in accordance with State and city statutes, is managed and controlled by a board of trustees. The board appointed the Comptroller of the City of New York and hired 10 outside investing firms to help it invest plan funds. The board uses employees of a city department to handle the plan's daily administrative operations.

The investment decisionmaking processes are discussed in detail in the case studies. As directed by your office, we have prepared this report without waiting for formal written comments from plan officials. However, we gave plan officials an opportunity to comment on the case studies, and we have included their comments where appropriate. We have requested formal written comments, which we will send to you when we receive them.

Comptroller General
of the United States

APPENDIX I

CASE STUDY

ON THE

NEW YORK STATE EMPLOYEES'

RETIREMENT SYSTEM

Contents

CHAPTER 1

BACKGROUND

The New York State Employees' Retirement System (hereafter referred to as the Plan) was established by Chapter 741 of the New York Laws of 1920. Under this legislation, only State employees were entitled to membership. Amendments to Chapter 741, however, authorized extension of Plan coverage to employees of the State's political subdivisions, public and quasi-public organizations, and certain New York City libraries.

As of June 30, 1976, the Plan had about 552,000 active members and paid about $26.5 million monthly to its 111,545 retirees and beneficiaries. As of March 31, 1975, the Plan had assets valued at about $6.1 billion. The Plan is the largest retirement system in the State and the largest State retirement system in the country.

The Plan is one of three State-administered retirement plans. The others are the (1) New York State Policemen's and Firemen's Retirement System and (2) New York State Teachers' Retirement System. According to the latest available information, these plans, as of June 30, 1976, had about 32,000 and 227,000 active members, respectively, and at the end of the plans' fiscal year ended March 31, 1975, had assets totaling about $900 million and $4.7 billion, respectively.

The Plan's management and investment activities are combined with the (1) New York State Policemen's and Firemen's Retirement System and (2) New York State Public Employees' Group Life Insurance Plan. The assets of the three plans are combined in an investment pool referred to as the Common Retirement Fund. A staff of State employees manages the fund's daily investment activities.

MEMBERSHIP REQUIREMENTS

Membership in the Plan is mandatory for all persons who entered or reentered the service of the State or participating political subdivisions on or after July 1, 1948, with certain exceptions. The exceptions, among others, include (1) teachers or instructors, policemen, and firemen, who are eligible for membership in other retirement systems, and (2) persons in positions that pay less than $1,500 a year.

Active membership in the Plan ceases upon the member's death or retirement or the member's voluntary withdrawal of all or part of his accumulated contributions. Membership is also terminated when service amounts to less than 5 years in any period of 10 consecutive years. However, membership shall not be terminated if, during the 10-year period, the member had at least 5 years of past service and served as an employee of the Federal Government, the United Nations, or another international organization.

FUNDING

The Plan is primarily funded through contributions from employers and income from investments. Originally, both employees and employers had to contribute to the Plan. However, during the past 16 years--to provide increased take-home pay to employees--the employers could elect continued membership participation for their employees under a Plan program that does not require any contributions by the employees or under one that permits reduced employee contributions.

During June 1976 about 2,500 of the Plan's 552,000 members were required to contribute to the pension programs. About 10,200 other members were making voluntary contributions. The contribution rates vary from 6.01 to 12.82 percent, based on the member's age, sex, and occupation. For example, a male enrolling at age 21 contributes 7.24 percent of his salary, whereas a female of the same age contributes 9.09 percent.

New pension legislation was enacted by the State legislature during the 1976 session. The chief feature of the legislation was that a member who joined or rejoined the Plan on or after July 1, 1976, would have to contribute 3 percent of gross salary to the Plan. The only exceptions were employees under the federally sponsored Comprehensive Employment and Training Act of 1973, as amended (29 U.S.C. 801).

BENEFITS

The Plan provides its members with retirement income and financial protection in the event of disability or death. Generally, the benefits available to members depend on whether they had joined or rejoined the Plan (1) before July 1, 1973, (2) between July 1, 1973, and June 30, 1976, or (3) after June 30, 1976. The enrollment dates differ to comply with the various provisions of law in effect during these periods.

The Plan offers a broad range of benefit programs. All programs provide normal retirement benefits, death and disability benefits, deferred retirement benefits, and optional methods of benefit payment. Benefits under the programs differ depending on the qualifying age or years of service, the date of membership, and whether the members are contributory or noncontributory. The program available to members is selected by the employer and is either a contributory, noncontributory, or special program.

Because of the complexity and variety of options offered to members, we have included excerpts from the Plan's Fifty-Fifth Annual Report, which describes each of the benefits available. This is included as schedule 2 on page 26.

Cost-of-living annuity adjustments

Legislation enacted in 1976 provides for escalating or deescalating service retirement, disability, and survivor benefits annually at a rate equal to the lesser of 3 percent, or the actual increase or decrease in the cost-of-living index. Benefits, however, cannot be deescalated below the benefits initially payable. The law applies only to members who joined after June 30, 1976, and has no provisions for cost-of-living adjustments before July 1, 1976.

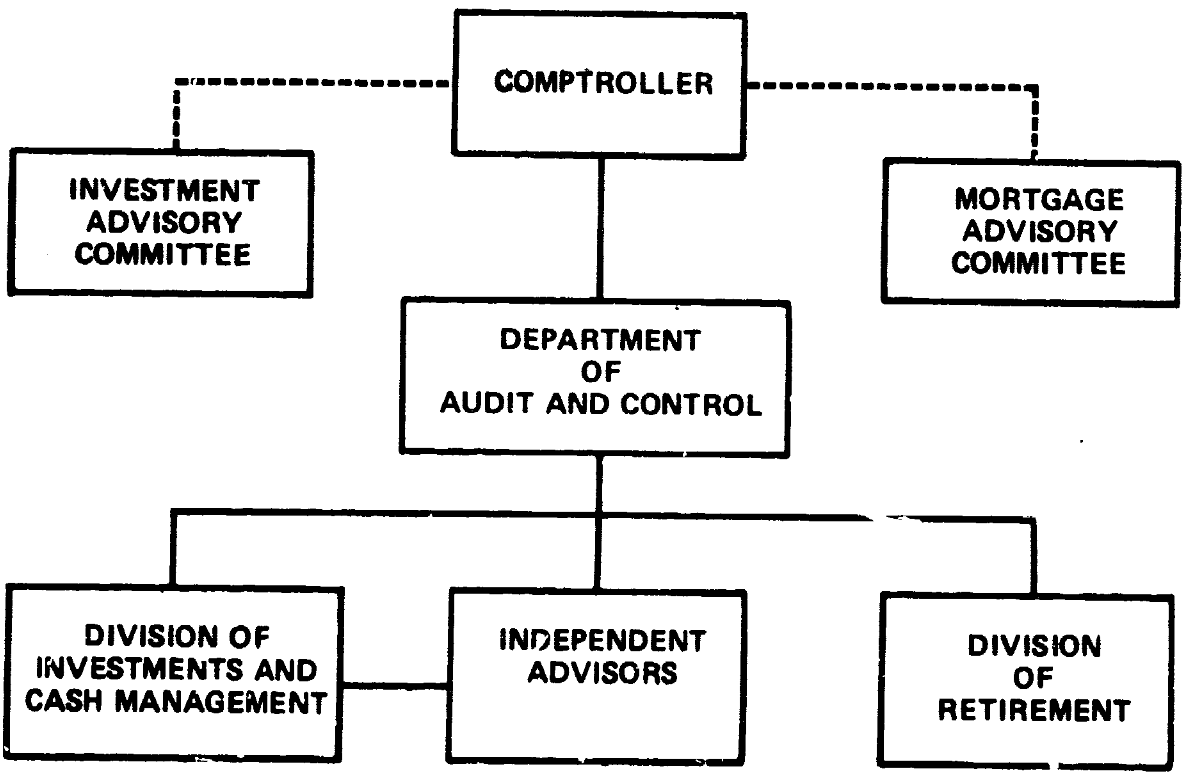
CHAPTER 2

FRAMEWORK FOR MANAGING INVESTMENTS

The State comptroller is designated by New York law as administrator of the Plan and the trustee of the Common Retirement Fund. The comptroller, as head of the State's Department of Audit and Control, draws on a variety of staff resources, advisory committees, and professional investment institutions to administer the Plan and manage the investment program.

ORGANIZATIONAL STRUCTURE

The following structure is used to manage and control Plan activities.



State comptroller

The State comptroller is administrative head of the Plan, trustee of the Common Retirement Fund, and appointing officer of the advisory committees. He is authorized by law to invest available funds for each retirement system and hold such investments in his name as trustee. Legislation also authorizes him to use any other technical and administrative assistance he needs.

Two committees--the Investment Advisory Committee and the Mortgage Advisory Committee--help the comptroller manage the Common Retirement Fund. The comptroller, as head of the Department of Audit and Control, exercises administrative control over the Plan and its investment program. He is the State's chief fiscal officer and is elected by the public for a 4-year term.

Investment Advisory Committee

The State law which established the Investment Advisory Committee provides that the committee shall (1) advise the comptroller on investment policies relating to the moneys of the Common Retirement Fund and (2) periodically review the fund's investment portfolio and make any recommendations deemed necessary.

Each committee member is required by law to be experienced in the field of investments and to have served as a senior officer or member of the board of an insurance company, banking corporation, or other financial or investment organization authorized to do business in the State. The committee must consist of at least seven members appointed by the comptroller for 4-year terms. The committee presently has nine members, who serve without compensation.

Mortgage Advisory Committee

A 1960 State law states that the comptroller shall appoint a separate Mortgage Advisory Committee, with the advice and consent of the Investment Advisory Committee, to review proposed mortgages and real estate investments by the Common Retirement Fund.

The comptroller has appointed 19 members to the committee; they also serve without compensation. The law does not specify an experience requirement for committee members. A Plan official said that the law does not provide for a specific term of office for committee members and that members may be replaced at the comptroller's discretion.

Department of Audit and Control

This department is primarily responsible for the Plan's administration, including the investment of Plan assets. The comptroller, as department head, has delegated this responsibility to two divisions within the department, the Division of Retirement and the Division of Investments and Cash Management.

Division of Retirement

The Division of Retirement is responsible for the overall administration of the Plan and the Policemen's and Firemen's Retirement System and the Public Employees' Group Life Insurance Plan. Specifically, the division:

--Maintains the accounts for the Common Retirement Fund, collects and accounts for the interest income and dividends earned on investments held for the fund, a services the mortgages held as investments.

--Calculates rates of return for various segments of the portfolio and determines the long-range rate of return used in calculating Plan liabilities.

--Executes transactions related to the acquisition and disposition of mortgages as investments for the Common Retirement Fund and manages any real property acquired in the fund's name.

The deputy comptroller is in charge of the Division of Retirement. He is assisted in the administration of the two systems by an executive director and in his other duties by various bureaus under his direction, such as the Accounting Bureau, the Actuarial Bureau, and the Office of Real Estate Investments. The division employs about 535 people. All employees, except the deputy comptroller, the director of the Office of Real Estate Investments, and the Counsel, are under the State's Civil Service System. A Plan official said persons holding these positions are appointed by the comptroller. According to the deputy comptroller, there are no specific job requirements for his position.

Division of Investments and Cash Management

The Division of Investments and Cash Management is responsible for administering the investment program for the Common Retirement Fund, except for mortgage investments. This includes buying and selling securities, determining whether certain stock investments are authorized, and safeguarding securities. The deputy comptroller told us that the division director is a civil service employee. A Plan official estimated that this division employs about 15 people, all of whom are civil service employees.

Independent advisors

The comptroller has contracted with five professional investment institutions to serve as independent advisors for the day-to-day common stock transactions of the Common Retirement Fund. According to a Plan official, these five independent advisors are banks. Four of them are headquartered in New York City and one is headquartered in Boston. He also said that one of the local advisors also serves as the Plan's bond advisor.

The deputy comptroller told us that the comptroller selects these advisors. The latest three advisors selected were selected by the comptroller, based on the advice of an actuarial firm, which considered the investment experience of 15 companies.

MAKING AND IMPLEMENTING INVESTMENT POLICY

According to Plan officials, the overall investment policy is established by the comptroller and the Investment Advisory Committee. The Director, Division of Investments and Cash Management, works closely with them in developing the policy.

The Plan may make no investment unless it is in accordance with the limitations set forth by State legislation. No limitations were established on the amount of funds that may be invested in Federal, State, and municipal obligations, including mortgages guaranteed by Federal agencies. Legislation does, however, establish the following limitations for investments of the Common Retirement Fund:

--No more than 30 percent of the fund may be invested in conventional mortgages, no more than 5 percent may be invested in any conventional mortgage, and no investment of less than $250,000 may be made in a mortgage.

--No more than 10 percent of the fund may be invested in any conventional mortgage guaranteed by a State bank or trust company.

--No more than 6 percent of the fund in any year or more than 35 percent of the total fund may be invested in stocks of corporations in which investments are permitted under applicable State laws.

--No more than 1.5 percent of the fund may be invested in the stock of any corporation, nor may the fund own more than 3 percent of the total outstanding shares of any corporation.

--No more than 30 percent of the fund may be invested in bonds or other obligations of railroad or utility corporations in which investments are permitted under applicable State laws. Additionally, no more than (1) 5 percent may be invested in equipment trust certificates, (2) 2.5 percent may be invested in obligations of any AAA-rated corporation, (3) 2 percent in any AA corporation, or (4) 1.5 percent in any A corporation.

The law specifies that all investments must have a rating of A or above assigned by a recognized rating agency, such as Standard and Poor's or Moody's.

Investment policies

The investment objectives of the Common Retirement Fund are consistent with the "prudent man rule"; that is, investment in securities that would be acquired by prudent men of discretion and intelligence in such matters who are seeking a reasonable income and the preservation of their capital. The objectives are to

--safeguard the principal from any imprudent risk;

--obtain the maximum yield consistent with the safety of principal;

--provide for the growth of principal through a long-term program of high-grade stock investments; and

--develop a portfolio which will emphasize quality, flexibility, diversity, and marketability.

According to a Plan official, no specific rate of return objectives have been established for investments.

Before 1959, the portfolio consisted entirely of U.S. Government and other governmental obligations, mortgages, and tax-exempt bonds. Legislation enacted in 1959 permitted investments in corporate obligations, railroad equipment trust certificates, and conditional sales notes. Further legislation in 1960 permitted investments in conventional mortgages; common stock; and Canadian Government, province, or city obligations. This expansion of investment options is reflected in the changing composition of the Plan's portfolio.

The Director, Division of Investments and Cash Management, said the current investment policy for the Common Retirement Fund favors investments in bonds, especially 10-year short maturity and tax-exempt bonds and high quality mortgages that guarantee 10-percent return. He said the Plan does not make loans to the State. However, employees may borrow from the Plan based on their contributions. Investment policies are reviewed and revised at quarterly meetings.

Implementing investment policy

The implementation of investment policy for the major areas of investments--stocks, bonds, mortgages, and short-term investments--is discussed below.

Stocks

According to Plan officials, the five independent advisors recommend investments to the comptroller. The comptroller consults with the director, Division of Investments and Cash Management, to determine whether the recommendations fall within the legislative limitations. Once approved, a transaction is made by an independent advisor through a brokerage firm of his choice. Brokerage firms do not deal directly with Plan personnel. The independent advisor submits confirmation of purchase or sale to the Division of Investments and Cash Management, which in turn disburses or collects funds. According to a Plan official, each of the five independent advisors is given a monthly dollar allocation and assigned part of the stock portfolio to manage.

Bonds

The deputy comptroller said one of the independent advisors makes recommendations to the comptroller on bond portfolio investments. Many recommendations involve bond swaps--the trading of low-yielding bonds for bonds with better returns. Actual transactions are carried out by the Division of Investments and Cash Management.

Mortgages

The Division of Retirement is responsible for the mortgage investment program. The deputy comptroller said that recommendations for mortgage investments originate within the division and are submitted to the comptroller and the Mortgage Advisory Committee for review. Unlike the Investment Advisory Committee, which only advises, the Mortgage Advisory Committee actually participates in the decisionmaking process. The committee, by law, must approve a proposed mortgage or real estate investment before it can be made. Once a mortgage investment decision is made, the division is responsible for executing the transaction, making onsite property inspections, and collecting delinquent payments. The division also collects escrow moneys, pays taxes and insurance, and identifies delinquent payments.

Short-term investments

The Division of Investments and Cash Management is solely responsible for short-term investments. All cash receipts throughout the year are invested in short-term securities, such as Treasury bills and certificates, to produce earnings before the cash is invested in long-term securities. The division director and three division investment officers, who serve as advisors, handle the short-term investments. All decisions regarding these transactions are made by the director.

Investments are restricted only by legislation. To carry out the short-term investment program, the division relies on a cash flow projection prepared by the Division of Retirement. This projection and the role it plays will be discussed in the section beginning on page 16.

Experience of investment decisionmaking staff

Each member of the Investment Advisory Committee is required by law to be experienced in the investment field and to have served as a senior officer or member of the board of an insurance company, banking corporation, or other financial or investment organization authorized to do business in the State. Although there are no experience requirements stated in the law for members of the Mortgage Advisory Committee, all 19 members are senior officers or board members of banks, insurance companies, or realty corporations.

The deputy comptroller said that the director, Division of Investments and Cash Management, is a civil service employee and that there are no job requirements for this position. The current incumbent, who has been the division director since 1946, holds a master's degree in public administration.

Initially, an independent advisor was engaged to manage the bond portfolio. In 1960, when common stocks became part of the Common Retirement Fund, the advisor was also selected to manage the stock portfolio. As the portfolio grew, another advisor was engaged. Each was allocated part of the portfolio to manage. As the stock portfolio continued to grow, Plan officials felt that more competition among advisors would benefit the portfolio.

A consulting firm was engaged to review the investment performance of various financial institutions and provide a report to the comptroller on which he could base the selection of additional stock advisors. The firm reviewed the performance of 15 companies with broad stock investment experience. The report included comparisons of the investment results achieved by the various institutions, along with illustrations of the general stock market performance based on the Standard and Poor's Composite Stock Index and the Dow Jones Average. The comparisons were based on total investment performance. The report also included the institutions' fee schedules.

The consulting firm suggested that the following factors be considered in selecting advisors:

--Ability of the financial institution to manage large common stock investment programs.

--Size of the financial institution, in terms of both assets managed and depth of staff.

--Expense charges to be levied by the financial institution.

--Depth of research and investment policy of the financial institution.

The report highlighted the 15 institutions reviewed and recommended 6 of them. Three of the institutions were then chosen as additional independent advisors. According to a Plan official, some of the independent advisors have since been replaced because of poor performance or high fees.

Selection of brokers

The deputy comptroller said the Plan does not select or deal directly with brokers. The five independent advisors do the selecting.

MANAGEMENT AND CONTROL OF PENSION PLAN ASSETS

The Plan has developed an automated investment information system to provide for complete accounting of investment transactions and income. The Accounting Bureau of the Division of Retirement is responsible for operating this system. The automated system facilitates the collection, editing, and analysis of the large volume of data generated and the timely and comprehensive review of the investment program by providing updated reports on all long-term stock and bond transactions. The reports generated are discussed on page 20.

The comptroller, by law, uses the services of a New York City bank as fiscal agent to help the State carry out control procedures. The fiscal agent is responsible for transferring and storing all securities. Negotiable securities--mostly short-term--are maintained with the fiscal agent. Where practical, securities, which are not readily negotiable, are registered in the name of the comptroller as trustee of the Common Retirement Fund. Physical custody of such securities is the responsibility of the Division of Investments and Cash Management.

The director of that division told us that no specific controls have been established to prevent "soft dollar" arrangements--the receipt of research from broker-dealers in exchange for commission business--or loans to other bank customers or broker-dealers who direct trade to their own firms. He said the Plan is dealing with reputable firms whose transactions are governed by Securities and Exchange Commission regulations.

Money management techniques

The deputy comptroller said that to make sure that incoming cash is invested immediately, the director, Division of Investments and Cash Management, develops a cash flow plan for anticipated cash receipts. The Division of Retirement is responsible for providing investment income data for cash management purposes. The Division of Retirement prepares a cash flow projection report which lists contributions, investment income, benefit payments, and other payments anticipated for the coming year as well as the amount available for investment. The director, Division of Investments and Cash Management, said that he is notified by the depository bank of the daily account balance. The forecasted available funds are invested immediately in short-term investments, mortgages, and stocks.

According to the director, Division of Investments and Cash Management, adherence to the statutory limitations is the best way of obtaining optimum return on and security of investments. To upgrade the portfolio wherever possible, a system of security exchanges has been implemented through which bonds are exchanged for higher yielding obligations. The law spells out the restrictions on this type of transaction.

Further, various controls have been set up to obtain optimum return on and safety of pension assets. For example, an investment may be made only within the limits authorized by law for the category of securities involved. The director, Division of Investments and Cash Management, said that he has a staff of investment officers who make sure that stocks and bonds purchased meet the quality restrictions of the law and that statutory limits are not exceeded.

Monitoring investment performance

The Division of Investments and Cash Management and the Actuarial Bureau of the Division of Retirement are jointly responsible for evaluating the performance of the independent advisors. The Plan's actuary said that the evaluation technique used considers many factors when computing rates of return. He said that it provides complete investment results by considering not only the income earned from interest or dividends, but also changes in market value of assets, which arise from both realized and unrealized gains and losses. The technique also includes (1) expression of investment results as annual rates of return, (2) recognition of cash flow--the length of time that funds were invested, (3) consideration of sufficiently long periods of time to obtain meaningful results, and (4) selection of time periods to illustrate results obtained during different periods and under different market conditions.

According to the actuary, the technique has been computerized and reports are prepared monthly. Meetings are held periodically with each independent advisor to discuss its performance and to compare it with the other four advisors. As a result, two advisors have been recently discharged because of poor performance. The actuary further stated that the bond advisor is not monitored because the Plan uses only one, thus no comparison can be made.

Disclosure statements

Plan officials said disclosure statements are not required from the comptroller or anyone else in the Plan. No disclosure statements have been filed. The State's Public Officers Law cites ethical standards for employees and public officials. Beyond the general requirements imposed on all public employees, the law places special responsibilities on Plan employees. The law states that, except as provided, neither the comptroller nor any person employed by the Plan shall

--have any interest in the gains or profits of any investment of the Plan, or receive any pay or emolument for his services;

--borrow for himself or as an agent or partner of others any of its funds or deposits or in any manner use the funds except to make current and necessary payments authorized by the comptroller; or

--become an endorser, surety, or an obligor in any manner of moneys loaned by or borrowed from such funds.

The deputy comptroller was unaware of procedures for disclosure statements followed by the banks handling the portfolio. The Plan has received no disclosure statements from the banks.

AUDIT AND DISCLOSURE OF INVESTMENT ACTIVITIES

Investment procedures and controls are subject to both internal and external audits. Auditors of the comptroller's office, who are independent of the operating divisions responsible for the investment program, make internal audits. State regulatory agencies and certified public accountants make external audits.

Scope of audits

Legislation requires that the Plan be subject to the supervision of the superintendent of insurance, in accordance with the provisions of the State insurance law. In this connection, the State's Insurance Department audits the Plan every 5 years. Its latest report, which covered the 5-year period from April 1966 to March 1971, dealt with the history, management, membership benefits, assets, and financial condition of the Plan.

The deputy comptroller, Division of Retirement, said there is no legal requirement for an annual audit of the Plan's operations by a certified public accounting firm. However, certified public accountants do take an annual inventory of securities, including an examination of vault controls and other custodial and safekeeping procedures required by State law for all State-owned securities.

The latest available report covered the year ended December 31, 1974. The accountants inspected or accounted for securities and other investments owned by the State and held and administered by the comptroller or the State's Commissioner of Taxation and Finance, including the Common Retirement Fund. A Plan official said the accountants reconcile their count with vault records and Division of Retirement records.

The comptroller has instituted a regular system of internal audits. A central internal audit staff audits all divisions of the Department of Audit and Control. Internal audits of the Division of Investments and Cash Management include review and evaluation of the (1) accounting and security aspects of investment operations, (2) results of operations for selected periods, (3) effectiveness of internal control systems, (4) interim reconciliations of State records with a physical count of securities, and (5) performance of the fiscal agent. Internal audits also seek to make certain that the investment function is adequately reviewed and evaluated.

According to the deputy comptroller the internal audits are not made on any formal basis at the Division of Retirement, nor is there a formal reporting system. No reports of internal audits of the Division of Retirement were published. He also said that the audit by the State Insurance Department is the only formal, complete audit of the Plan's operation.

Reports issued on retirement plan activities

The comptroller issues an annual report on Plan operations. The report includes a list of the entire investment portfolio and the actuarial report. It also includes the amount of assets by type of investment, rates of return by type of asset for various years, and rates of return for investments acquired in the current year. The annual report is sent to each public retirement system in the country, each participating employer, public hospitals and libraries, retirement information representatives of the Plan, and the New York State Exchange Library.

The Division of Retirement's Accounting Bureau prepares an annual financial report. This report, which is sent to the comptroller, consists of detailed financial statements of the Plan. The Plan and the Common Retirement Fund are also required by law to report to the State Insurance Department. This department requires detailed schedules showing investments held at yearend and investment transactions that occurred during the year.

The Department of Audit and Control publishes a monthly pamphlet of State financial data. The pamphlet includes data on the Common Retirement Fund and the Plan along with a summary of investments, by type and rate of return of each type, as well as membership and benefit information.

The automated investment information system provides detailed lists and records covering all phases of investment activity concerning long-term bond and stock investments. These records provide a detailed account of purchases, sales, maturities, receipt of interest or dividend payments, and related information. The records are usually in the form of printouts and are not published. From these accounting records, internal reports are prepared that provide comparisons, analyses of performance, and historical records of investment activity to be used for investment management.

CHAPTER 3

INVESTMENT EXPERIENCE

ANNUAL RATE OF RETURN

The following table shows the annual rate of return for common stock and fixed dollar investments (primarily bonds and mortgages) for fiscal years 1971-75, as shown in the Plan's annual reports. Except for fiscal year 1971, the annual reports did not present an overall rate of return on Plan investments.

Fiscal year	Percent return: Common stock	Percent return: Fixed dollar investments
1971	-	a/4.85
1972	10.50	5.23
1973	8.80	5.30
1974	.90	5.90
1975	-1.70	6.30

a/Represents rate of return for all investment assets, including stocks. At the end of fiscal year 1971, stocks accounted for 16.6 percent of total investments.

The actuary said that the rate of return for common stock is computed according to the method used for performance monitoring. This computation includes income from dividends, unrealized gains and losses from appreciation or depreciation, and realized gains and losses from the sale of assets. The yield included the changes in market values from November 28, 1960, to the end of each fiscal year. The rate of return for total fixed dollar investments is obtained by dividing the income earned during the year by the average asset value for the year. Neither realized nor unrealized gains and losses are considered in this computation.

According to the Plan's actuary, the rate of return for common stock could be computed considering only income and excluding gains and losses. However, computing the rate of return for fixed dollar investments including realized and unrealized gains and losses would be very time consuming because it would require writing a computer program and accumulating raw data which might not be available.

PENSION PLAN ASSETS

The values of assets held in the Common Retirement Fund, listed in the annual reports as of March 31 for fiscal years 1971-76, were as follows:

Fiscal year	Amount
1971	$4,596,908,224
1972	5,376,646,208
1973	6,091,833,519
1974	6,472,094,279
1975	7,139,770,200
1976	8,292,245,439

A comparison of the assets by category for the 6-year period is shown in schedule 1 on page 25. During that period, about 82 to 86 percent of the assets were invested in stocks, bonds, and mortgages.

FUNDS IN NON-INTEREST-BEARING ACCOUNTS

Four non-interest-bearing checking accounts are maintained for the Plan and the Common Retirement Fund. A regular account and an escrow account are maintained for the fund. A pension account for paying benefits and payroll expenses and a revolving fund account for such payments as withdrawals of contributions and loans to members are maintained for the Plan. We analyzed the accounts of the Common Retirement Fund and the Plan for the months October 1975 to March 1976. The following table shows the average daily balances and monthly expenditures from the four non-interest-bearing accounts. The average daily balance was computed by totaling the daily balances and dividing the total by the number of days in the month, excluding weekends and holidays.

	Common Retirement Fund			
	Regular account		Escrow account	
Month	Average daily balance	Monthly expenditures	Average daily balance	Monthly expenditures
October	$2,064,299	$559,767,681	$23,440	$6,554,073
November	259,313	198,791,151	15,028	2,381,263
December	1,596,216	592,400,508	18,237	2,297,771
January	1,116,824	178,017,420	26,262	7,374,907
February	1,387,445	409,368,358	32,351	1,297,720
March	1,186,740	350,303,273	39,776	2,029,104

	Plan			
	Pension payroll account		Revolving fund	
Month	Average daily balance	Monthly expenditures	Average daily balance	Monthly expenditures
October	-$3,263,066	$27,662,137	-$1,196,521	$10,223,614
November	-4,272,035	26,627,606	-1,312,467	8,883,046
December	-2,855,990	26,687,075	-1,290,605	7,841,480
January	-3,306,029	27,624,098	-1,276,203	6,099,145
February	-4,228,175	27,449,609	-1,177,843	5,887,429
March	-3,157,314	28,729,604	-1,254,720	7,684,032

The director of the Accounting Bureau did not believe the balances in the Common Retirement Fund accounts were unreasonable considering the amount of expenditures.

The director also told us that, for the Plan accounts, a "managed overdraft policy" is followed. Under this policy, frequent deposits are made in amounts sufficient to cover checks presented to the banks for payment. As a result of the policy, the amount of cash recorded in the books of account will frequently be negative--as illustrated in the above table--while the checking accounts will not show any overdrafts.

Our review of the balances recorded in the pension payroll account showed that during about the first half of each month a negative cash balance is recorded, but during the rest of the month the cash balance generally showed zero or an insignificant amount. Our review of the balances recorded in the revolving fund account showed that the account generally has negative balance, except on the last working day of the month, when a positive amount is shown. According to the director. at the end of the month a deposit is made to bring the book balance up to about $50,000.

OPERATING COSTS

By law, operating costs can be paid only out of the Common Retirement Fund revolving fund. Disbursements are made directly from the fund. The director of the Accounting Bureau said that charges are prorated against each participating system. A Plan official told us that operating costs included salaries, rent, supplies, and utilities. They do not include fees paid to advisors, which are paid out of investment proceeds.

All participating employers are required to make an annual contribution to cover the Plan's operating costs. This contribution, which is determined separately from the retirement contribution, is computed by dividing the current year's operating costs by the total current annual payroll of all participating employers. The resulting percentage is applied to each employer's total payroll to arrive at the employer's contribution.

The following table shows the Plan's operating costs and contributions for fiscal years 1971-76.

Fiscal year	Operating costs	Contributions	Operating costs as a percent of contributions
1971	$5,678,654	$377,692,671	1.50
1972	6,404,986	508,202,479	1.26
1973	6,993,963	565,309,199	1.24
1974	7,117,816	640,384,213	1.11
1975	8,474,707	701,242,201	1.21
1976	9,008,122	802,641,410	1.12

SCHEDULE 1

COMMON RETIREMENT FUND

(INCLUDING THE NEW YORK STATE EMPLOYEES' RETIREMENT SYSTEM)

COMPARATIVE STATEMENT OF ASSETS AS OF

MARCH 31, 1971, 1972, 1973, 1974, 1975, AND 1976 (note a)

Assets	1971 Amount	1971 Percent	1972 Amount	1972 Percent	1973 Amount	1973 Percent	1974 Amount	1974 Percent	1975 Amount	1975 Percent	1976 Amount	1976 Percent
Cash (note b)	$ 487,809	0.01	$ 1,439,628	0.02	$ -13,947,919	-0.23	$ -13,782,675	-0.21	$ -16,498,044	-0.23	$ -19,525,317	-0.24
Bonds:												
Government	1,005,988,819	21.88	920,727,251	17.12	775,363,183	12.73	654,581,977	10.11	661,919,693	9.27	1,402,248,685	16.91
Corporate	1,226,728,448	26.69	1,519,332,211	28.26	1,942,815,551	31.89	2,194,534,651	33.91	2,339,437,016	32.77	2,303,324,039	27.78
Mortgages:												
Guaranteed	659,430,068	14.35	634,825,273	11.81	645,245,397	10.59	601,948,160	9.30	564,124,395	7.90	530,090,802	6.39
Conventional	273,967,622	5.96	291,916,485	5.43	343,566,268	5.64	559,755,937	8.65	887,547,550	12.43	999,664,699	12.06
Advances (note c)	31,709,140	.69	57,682,748	1.07	-	-	217,394	.00	3,818,557	.05	5,147,500	.06
Stocks	740,763,735	16.11	1,115,446,508	20.75	1,372,246,546	22.53	1,319,139,985	20.85	1,416,816,252	19.84	1,756,038,752	21.18
Accounts receivable	561,668,172	12.22	710,758,717	13.22	837,419,510	13.75	921,909,736	14.24	1,023,021,027	14.33	1,080,528,424	13.03
Other	96,164,392	2.09	124,517,387	2.32	189,124,983	3.10	203,789,113	3.15	259,583,754	3.64	234,727,855	2.83
Total	d/$4,596,908,224	100.00	$5,376,646,208	100.00	$6,091,833,519	100.00	d/$6,472,094,279	100.00	$7,139,770,200	100.00	$8,292,245,439	100.00

a/Data obtained from annual reports for fiscal years 1971-75 and unpublished financial statements for fiscal year 1976.

b/Includes some negative balances in accordance with the "managed overdraft policy" discussed on page 23.

c/Represents advances for both guaranteed and conventional mortgages.

d/Figures do not add due to rounding.

SCHEDULE OF BENEFITS

[Extracts from the 55th Annual Report, The New York State Employees' Retirement System (ERS), The New York State Policemen's and Firemen's Retirement System (PFRS), and The New York State Public Employees' Group Life Insurance Plan, fiscal year ended March 31, 1975.]

Legislation enacted in 1973 substantially revised certain aspects of the Retirement Systems. A new class of members was created--those who entered or re-entered the Systems after June 30, 1973. Existing benefits were modified, when applicable to new members of ERS. In one instance, death benefits, a new formula was mandated for new members of ERS and PFRS.

The normal retirement age for Post-July 1, 1973 members is 62, unless they are in a plan which uses years of service as its only criterion. Retirement is permitted members between age 55 and 62 but with a reduction in benefits according to the following formula:

1) One-half of 1% per month for each of the first twenty-four full months that retirement predates age 62.

2) One-quarter of 1% per month for each full month that retirement predates age 60. In no event is retirement allowed before age 55.

Retirement benefits for Post-July 1, 1973 members, except any attributable to their own contributions, are subject to a limit. The maximum benefit for ERS members, computed without optional modification, may not exceed 60% of the first $12,000 of final average salary and 50% of any final average salary in excess of $12,000. For policemen and firemen, the maximum benefit equals the amount payable upon completion of 30 years of service.

Other limitations applicable to this group are noted, where appropriate, throughout this summary.

Service Retirement Allowances and Employee Contributions

1. Contributory Plans [See GAO note.]

GAO note: The various retirement options included in this schedule are referred to as plans. Within the case study, we referred to these plans as programs in order to minimize confusion with the term "Plan" which we used in referring to the New York State Employees' Retirement System.

SCHEDULE 2

If a member's employer has not elected a non-contributory plan, the employee has a choice between the Age 55 Plan and the Age 60 Plan (unless the employee is covered by a special plan.)

A. Age 60 Plan

Pre-July 1, 1973 members may retire at or after age 60, regardless of length of service, with a pension of 1/140th of final average salary for each year of member service plus 1/70th of final average salary for each year of prior service (to a maximum of 35 years) plus an annuity purchased by member contributions.

The same benefit formula applies to Post-July 1, 1973 members but these members must meet the criteria mentioned in the introductory paragraphs.

This plan requires member contributions, the rate of contribution being based on occupation, sex, and age at entry into membership. These contributions are lower than those for the other contributory plan.

B. Age 55 Plan

Pre-July 1, 1973 members may retire at or after age 55, regardless of length of service, with a pension of 1/120th of final average salary for each year of member service plus 1/60th of final average salary for each year of prior service (to a maximum of 35 years) plus an annuity purchased by member contributions. The same benefit formula applies to Post-July 1, 1973 members but these members must meet the criteria mentioned in the introductory paragraphs. The contribution rates for this plan are greater than those for the Age 60 Plan.

C. Increased-Take-Home-Pay Provision

For most of the members covered by contributory plans, the required contributions have been reduced by the decision of the employer to make contributions to a reserve for Increased-Take-Home-Pay (ITHP). If an employer makes such ITHP contributions, they replace part or all of the member's own contributions. To that extent, a reserve is established which accumulates with regular interest and is used to provide additional income to the member at the time of retirement.

SCHEDULE 2

Since April 1, 1960 employers could elect to make ITHP contributions equal to 5% of the member's gross salary. Beginning April 1, 1964, employers could elect to provide either a 5% or 8% ITHP contribution. As of April 1, 1965, employers could elect the 5% or 8% ITHP contribution, or a fully non-contributory plan. The fully non-contributory ITHP plan was closed to new election as of July 1, 1966.

2. Non-Contributory Plan

There are four non-contributory retirement plans: Employees enrolled in any one of these plans are not required to contribute. Pre-July 1, 1973 members may retire at or after age 55. Post-July 1, 1973 members must meet the criteria mentioned in the introductory paragraphs.

A. Non-Contributory Plan (1/60th Plan)

At retirement, a member will receive a pension equal to 1/60th of final average salary for each year of member service rendered after April 1, 1960, plus 1/120th of final average salary for each year of member service rendered before April 1, 1960, plus an annuity from any accumulated contributions left on deposit with the System. Each year of prior service (up to a maximum of 35 years) will increase the pension by 1/60th of final average salary.

B. Non-Contributory Plan with Guaranteed Benefits (Improved 1/60th Plan)

A member will receive at retirement a pension equal to 1/60th of final average salary for each year of service since April 1, 1960 plus a pension that will produce, when added to the annuity purchasable by required member contributions, a retirement allowance of 1/60th of final average salary for each year of service between April 1, 1938 and April 1, 1960. All member contributions since April 1, 1960 and those in excess of the contributions required under the Age 60 Plan for the years between 1938 and 1960 will, if left in the System, purchase additional annuity. Service before April 1, 1938 is credited in the same manner on the Improved 1/60th Plan as it is on the 1/60th Plan. Each year of prior service (to a maximum of 35 years) will increase the pension portion of the retirement allowance by 1/60th of final average salary.

 SCHEDULE 2

C. Career Plan (25 Years)

A member retiring with at least 25 years of total service (member service plus prior service) will receive a retirement allowance of 1/50th of final average salary for each of the first 25 years of service plus 1/60th of final average salary for each year in excess of 25, provided that required contributions are on deposit. Members retiring with fewer than 25 years of service will receive the Improved 1/60th Plan benefit.

D. New Career Plan (20 Years)

A member retiring with 20 or more years of total service (member service plus prior service) will receive a retirement allowance of 1/50th of final average salary for each year of service, provided that required contributions are on deposit. For members who retire with fewer than 20 years of total service, the retirement allowance is calculated according to the terms of the Improved 1/60th Plan.

3. Special Plans

A. 25 Year Plans

A variety of 25 year plans are offered to policemen, firemen, sheriffs and correction officers. Generally, members may retire with 25 years of service, regardless of age, or at age 60, with a retirement allowance of 1/50th of final average salary for each year of service (to a maximum of 25 years). Allowances are funded by employer and member contributions. Member contributions may be replaced (to the extent of 5% or 8% of pay) by ITHP contributions, or the employer may provide the plan on a non-contributory basis.

20 Year Plans

These Plans are offered to officers and members of certain police and fire departments. A member receives a retirement allowance equal to 1/40th of final average salary for each year of service (to a maximum of 20 years). Allowances are funded by employer and member contributions. Members contributions may be replaced (to the extent of 5% or 8% of pay) by ITHP contributions, or the employer may provide the plan on a non-contributory basis.

SCHEDULE 2

20 Year Plan for New York State Police

Upon the completion of 20 years of total service, a New York State Trooper may retire and receive a retirement allowance of 1/40th of final average salary for each year of service. Troopers retiring with more than 20 years of service, but not more than 30, will receive an additional benefit of 1/60th of final average salary for each year of service in excess of 20. With certain exceptions, no credit is allowed for service beyond 30 years. Most members must retire on December 31st of the year in which they attain age 55.

4. Vested Retirement Benefit

The vested retirement benefit is available to a member who is not eligible to retire but leaves service after rendering 10 years, including a minimum of five years of member service. For Post-July 1, 1973 members, the five years of member service must follow after July 1, 1973. Members who "vest" their retirement allowance must leave any required contributions on deposit. Upon attaining age 55, 60 or 62, depending on the plan by which they were covered when they left service, they must submit applications for retirement. The vested retirement allowance is generally computed in accordance with the provisions of the plan they were covered by when last in service.

Disability Retirements

1. Ordinary Disability Retirement

This benefit becomes available after the member has rendered 10 years of total service, if he or she is incapacitated for the performance of duty. The benefit is meant to be 1/60th of final average salary for each year of service. Certain factors, however, may reduce the amount. The minimum allowance, again with certain exceptions, is 1/3rd of final average salary.

2. Accidental Disability Retirement

This benefit is available to a member, regardless of length of service, if he or she is incapacitated for the performance of duty as the result of an accident which occurred in the performance of duty, and not as the result of the member's negligence, and if the member applies for the benefit prior to attaining age 60.

SCHEDULE 2

The allowance for Pre-July 1, 1973 members consists of a pension which is equal to 3/4ths of final average salary, plus an annuity provided out of the member's accumulated contributions, if any. For Post-July 1, 1973 members, the allowance is equal to 60% of the first $12,000, of final average salary and 50% of any final average salary over $12,000, plus an annuity provided out of the member's accumulated contributions, if any. The pension is subject to reduction on account of Workmen's Compensation awards.

Supplemental Retirement Allowances

Supplemental payments relate to the first $8,000 of an eligible member's unmodified allowance and are made to all service retirees who retired before January 1, 1969 and who attained age 62 on or before May 31, 1972 and to all disability retirees regardless of age. Supplemental allowances are not payable to benficiaries or designated annuitants.

The supplemental retirement allowances are subject to renewal by the Legislature each year. The 1975 legislation provided for continuation of the cost-of-living supplements which were already being paid.

Death Benefits

1. Ordinary Death Benefits for Pre-July 1, 1973 Members

This benefit is paid upon the death, before retirement, of a member who meets the eligibility requirements as set forth in the Law. With some exceptions, the benefit payable on account of a member who, at the time of death, would have been eligible for a service retirement benefit is one of the benefits outlined below or an amount based on the pension reserve that would have been established had the member retired on the date of death, whichever is larger. In most cases, such reserves are limited so as to exclude the additional benefits contained in retirement plans enacted since 1967.

The first $50,000 of a member's ordinary death benefit (excluding return of the member's contributions with interest) is paid in the form of group term life insurance.

A. Contributory Plan Benefit

The benefit is equal to one month's salary for each year of service during the first 12 years

SCHEDULE 2

of service, plus an additional benefit of one month's salary for each additional two years of service. The maximum ordinary death benefit is two year's salary. In addition, the member's accumulated contributions are returned. Both the accumulated contributions and the ordinary death benefit are payable to the beneficiary either in a lump sum or in the form of an annuity.

B. Non-Contributory Plan Benefit

A special death benefit for members under the terms of the non-contributory retirement plan provides for one month's salary for each year of service up to 36 years.

C. Guaranteed (Minimum) Benefit

New York State employees and members whose employer have elected this benefit are covered by a "guaranteed" (minimum) ordinary death benefit of three times annual salary raised to the next multiple of $1,000, but not to exceed $20,000. New York State Police and State employees who are members of the Security Services Unit are also covered by a minimum ordinary death benefit of three times annual salary raised to the next multiple of $1,000 but with no limitation.

2. Ordinary Death Benefits for New Members (Post-July 1, 1973)

New members must elect, at the time they first become a member of the Systems, either of the following benefits:

1) An ordinary death benefit of one month's salary per year of service up to a maximum of three years' salary after 36 years of service with an alternative formula ("death gamble") applicable to those who die in service after attaining normal retirement age; or

2) A benefit of one year's salary per year of service up to a maximum of three years' salary subject to the following limitations:

SCHEDULE 2

Age when Last Became a Member	Maximum Benefit
52	2-1/2 x salary
53	2 x salary
54	1-1/2 x salary
55-64	1 x salary
65 & Over	$1,000

While in service, the benefit is reduced by 10% yearly after attainment of age 61. Upon retirement, the benefit is reduced to 50% the first year, 25% the second year and 10% thereafter. In no case is the benefit ever reduced below 10% of the benefit in force at either age 60 or the date of retirement if that preceded age 60.

3. Accidental Death Benefits

This benefit is payable upon the death of a member as the result of an accident which occurred in the performance of duty. This benefit is payable to the widow until remarriage, or if there is no widow or child, to a dependent parent.

The accidential death benefit is a pension equal to one-half of final average salary. It is subject to reduction by Workmen's Compensation benefits. In addition, any accumulated contributions are paid to the designated beneficiary.

If the accidental death benefit payments, including payments made or to be made under the Workmen's Compensation Law, are less than the amount which would have been payable as an ordinary death benefit, the difference is paid to the beneficiary or to the member's estate.

Options

At the time of retirement, a member may elect to receive the retirement allowance in any one of several forms. Each form is known as an option.

Once payment of the retirement allowance has started, the pensioner may not change the option. Following is a brief description of each of the options:

Option 0 (Single Life Allowance):

SCHEDULE 2

The Single Life Allowance is also known as Option Zero. It provides the maximum retirment allowance to the pensioner and is payable for life. All payments cease at the pensioner's death and no payments are made to any beneficiary.

Option 1/2 (Cash Refund - Contributions):

Under Option 1/2, pensioners are assured that their accumulated contributions will be returned in full either to them or to their beneficiaries. If the pensioner should die before the annuity portion of the retirement allowance has amounted to the pensioner's accumulated contributions at the time of retirement, the balance thereof would be paid to the beneficiary in a lump sum. The beneficiary may elect to receive this lump sum in the form of a life annuity or a reduced life annuity. The pensioner has the privilege of changing the beneficiary at any time. Because of the assurance provided by this option, the annuity portion of the retirement allowance is less than it would be under Option 0. The pension portion is the same as it would be under Option 0.

Option 1 (Cash Refund - Annuity Value): (available to Pre-July 1, 1973 members only)

Under Option 1, pensioners are assured that both their accumulated contributions and the reserve established by the employer will be paid to them or their beneficiaries. If the pensioner should die before the retirement allowance has amounted to the pensioner's accumulated contributions plus the reserve established by the employer at the time of retirement, the balance would be paid to the beneficiary in a lump sum. The beneficiary may elect to receive this lump sum in the form of a life annuity or a reduced life annuity. The pensioner has the privilege of changing the beneficiary at any time. Because of the assurance provided by this option, the retirement allowance is less than it would be under Option 0.

Option 2 (Joint Allowance - Full):

Under Option 2, the pensioner will receive an allowance for life and if the beneficiary is alive at the time of the pensioner's death, the beneficiary will receive the same retirement allowance for the remainder of his or her lifetime. In this case, the beneficiary cannot be changed. Because two persons are involved instead of one, the retirement allowance will be less than it would be under Option 0.

Option 3 (Joint Allowance - Half):

Under Option 3, the conditions are exactly the same as under Option 2, except that the beneficiary will receive one-half of the retirement allowance which the pensioner had been receiving.

Additional Options for New Members

Five Year Certain

Under this option, payment is made to a pensioner for life with a guarantee that, even in the event of death, payments will continue for five years after retirement.

Ten Year Certain

Payments are made to the pensioner for life with the assurance that, even in the event of death, payments will continue for ten years after retirement.

- - - -

[GAO note: In interpreting the preceding benefits, the following definitions are used.]

Accumulated Contributions - The total contributions made by a member, with interest.

Annuity - That part of the retirement allowance derived from a member's accumulated contributions.

Beneficiary - A person receiving a payment or payments from the System by reason of the membership of a spouse or other person.

Designated Annuitant - A beneficary who chooses to receive a benefit as an annuity rather than a lump sum payment.

Employer - The State or other public agency participating in the System.

Final Average Salary - For pre-July 1, 1973 members, the highest average annual compensation earned during any three consecutive years of member service. For post-July 1, 1973 members, the highest average annual compensation earned during any three consecutive years. Where an employer has so elected, the final average salary may be based on the final year of member service.

SCHEDULE 2

Member Service - Service rendered in the employ of the State, or a participating public agency, while eligible for membership.

Non-Contributory - The member is not required to make any contribution.

Option - One of the several forms in which a retirement allowance may be paid.

Pension - That part of the retirement allowance derived from contributions made by the employer.

Pensioner - A member of the System who has been retired and is receiving a retirement allowance.

Prior Service - Service rendered to a participating employer before that employer elected to participate in the System.

Retirement Allowance - The monthly payment for life consisting of the pension, the annuity, if any and the ITHP pension, if any.

APPENDIX II

CASE STUDY

ON

THE TEACHERS' RETIREMENT SYSTEM

OF THE

CITY OF NEW YORK

Contents

CHAPTER 1

BACKGROUND

The Teachers' Retirement System of the City of New York (hereafter referred to as the Plan) was established on August 1, 1917, under the authority of Chapter 303 of the New York State Laws of 1917. The Plan is governed by Title B, Chapter 20, of the Administrative Code for the City of New York; the Retirement and Social Security Law of New York State; and New York insurance and banking laws.

The Plan is one of five retirement plans for city employees. As of June 30, 1975, the Plan was the second largest city retirement plan with about 83,000 active members and assets totaling about $3 billion. The other four city plans had about 257,000 active members and assets of about $5 billion. As of that date, the Plan was paying about $18 million monthly to its 25,652 retirees and beneficiaries.

Management and investment of the Plan's assets are separated into three programs--a fixed annuity program, a variable annuity program, and a tax-deferred annuity program. The purpose of each of these programs is described in chapter 2, in the section on investment policy.

The Plan is managed and controlled by a board of trustees. To assist it, the board has appointed the comptroller of the city of New York to manage funds of the fixed annuity program and has hired 10 outside investing firms to manage the funds of the variable annuity program. The comptroller and the outside investing firms coinvest the funds of the tax-deferred annuity program.

MEMBERSHIP REQUIREMENTS

Membership requirements are established by the city's Administrative Code. Plan members include the following employees of the city's boards of education and higher education institutions:

--Full-time teachers, instructors, and professors of public schools and colleges.

--Part-time lecturers of municipal colleges.

--Supervisory and administrative teaching personnel of public schools and colleges, such as superintendents, associate and assistant superintendents, principals, vice principals, and department heads.

Generally, membership is (1) mandatory for regular employees in a teaching or other related position in the city's public schools and colleges and (2) optional for part-time college lecturers. Since 1967, public college faculty members have had the option of joining the Teachers' Insurance and Annuity Association, a privately operated nationwide retirement system.

FUNDING

Funds needed to finance the Plan come from earnings on investments and contributions by employees and the city's employing boards of education and higher education institutions. The Plan's enabling legislation requires that all employees contribute through payroll deductions. Members' contributions are based on a percentage of their gross salary. The contribution rate is actuarially determined, based on the member's age on commencing employment, sex, years of service, and the type of pension program selected--either the 20-year pension option or the age-55-increased-benefits option. Under both options, separate rate tables are maintained for males and females. For example, under the 20-year pension option, a male at age 25 with 1 year of prior service contributes 5.05 percent, whereas a female under the same conditions contributes 5.45 percent. Moreover, the minimum rates at age 46 with no prior service are 2.70 percent for males and 3.15 percent for females.

At each member's option, contributions are reduced by (1) the city's contribution for increased take-home pay, described below, and (2) the member's required Federal Social Security contribution.

Since July 1, 1960, the city has contributed a portion of each employee's required contribution, in order to increase the member's take-home pay without increasing his gross salary. The city's portion of the member's required contribution, which has varied between 2.5 to 8 percent from 1960 to 1975, is currently 2.5 percent.

In addition, the city contributes annually to the fixed annuity program an actuarially determined amount which provides all benefits that are not included in the annuities paid from members' contributions, such as group term life insurance. The city also contributes to the fixed annuity program (1) amounts that will amortize various unfunded accrued liabilities over periods established by law and (2) an amount which will, over the next 20 years, amortize investment losses in accordance with legislation. The city makes increased-take-home pay contributions to the variable annuity program. The city makes no contributions to the tax-deferred annuity program but guarantees the benefit payments to retired members.

Before July 1, 1971, all the city's contributions to the Plan were paid in the year the liability was incurred. Effective on that date, however, legislation deferred payment of the city's contributions so that they can be paid 2 years after the liability is incurred.

BENEFITS

The Plan offers a variety of benefits, including normal retirement benefits, disability retirement and death benefits, and deferred retirement benefits. Because of the complexity of the benefits, we have included excerpts from the Plan's Fifty-Seventh Annual Report, which describes each of the benefits available. This is included as schedule 2 on page 63.

In addition, the Plan offers supplemental retirement allowances and cost-of-living increases.

Supplemental retirement allowances

Teachers who retired before October 1, 1968, with at least 10 years of credited service are entitled to a supplemental retirement allowance. This supplement is based on the year of retirement and the years of service. For example, teachers who retired in 1955 receive a 58.8-percent supplement to their monthly benefits, whereas those who retired in 1967 receive a 9.8-percent supplement.

State laws of 1973 liberalized the allowances so that benefits are now based on the first $8,000 of annual pension and the 1969 Consumer Price Index and are payable to those pensioners who had attained age 62 on or after October 1, 1968, and had retired before January 1, 1968. The law requires that the computation be developed by the city actuary and certified to the comptroller. A separate fund, financed by the city and under the control of the comptroller, is used to pay the supplemental allowances.

Cost-of-living annuity adjustments

Under State law, the increase or decrease of normal retirement, disability, and survivor benefits is provided annually at a rate equal to the lesser of 3 percent or the actual increase or decrease in the cost-of-living index. Benefits cannot be decreased below the benefits initially paid.

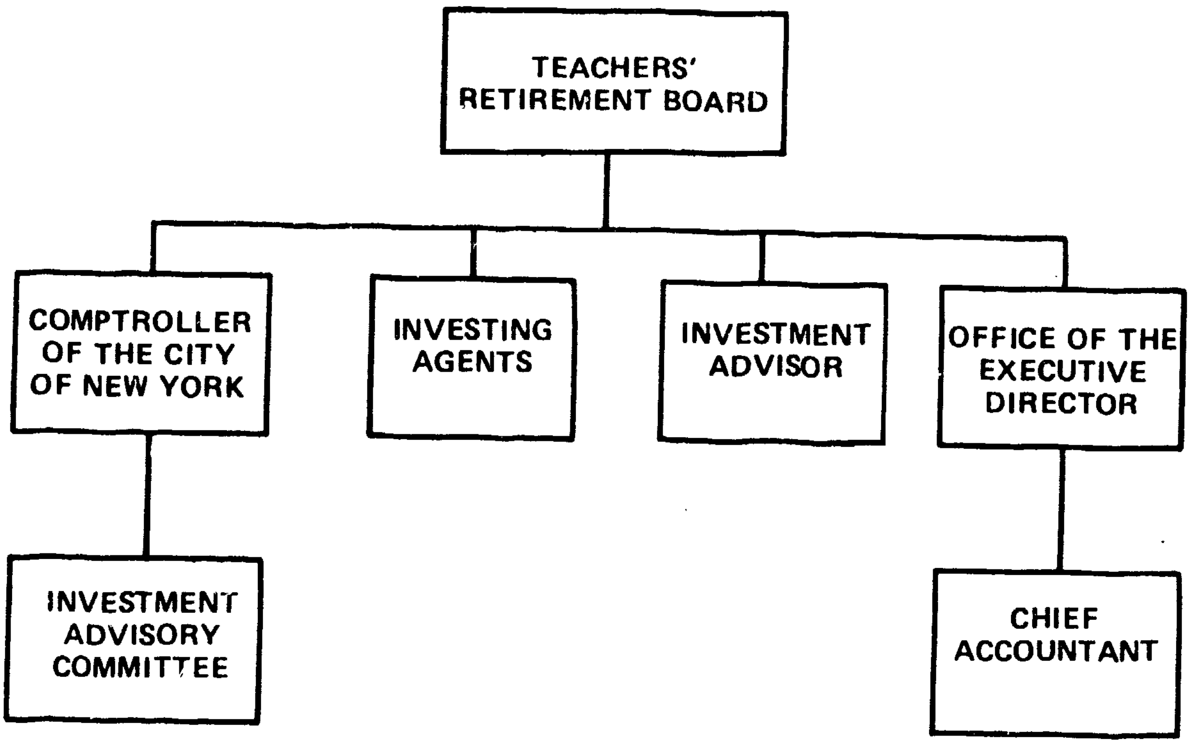
CHAPTER 2

FRAMEWORK FOR MANAGING INVESTMENTS

The city's Administrative Code places responsibility for the administration and proper operation of the Plan under the trusteeship of a Teachers' Retirement Board. To assist it, the board has appointed an executive director to handle the day-to-day administrative activities. The board has also contracted with 10 investing agents and appointed the comptroller of the city of New York to handle Plan investments. An outside investment consulting firm has also been hired to monitor the performance of the investing agents.

ORGANIZATIONAL STRUCTURE

The following chart shows the structure established to manage and control Plan activities.



Teachers' Retirement Board

The board is responsible for managing the Plan and is granted the powers and privileges of a corporation. Board members are trustees of Plan funds, subject to conditions and limitations imposed by law, as discussed in the section beginning on page 47. The board has the power to hold, purchase, sell, assign, transfer, and dispose of the Plan's securities and investments. City law authorizes the board to hire investing agents to provide investment advice and manage portions of the Plan's assets. (Investment activities of the agents are described in the section beginning on p. 48.)

The board consists of seven members, including the comptroller of the city of New York and the president of the city's board of education. The comptroller, elected through citywide vote, serves for 4 years. The president of the board of education is elected by fellow members, who are in turn appointed by the city's mayor and borough presidents. Of the remaining five members, two are appointed by the mayor and three are elected by Plan members and are themselves Plan members. Of the two appointed board members, one must be a member of the board of education (other than the president). The other need not have any special qualifications. The appointed board members serve until a successor is appointed and the elected board members serve 3-year terms.

Each board member serves without compensation, except for such necessary expenses as travel and printing incurred in serving on the board.

Office of the Executive Director

This office is responsible for the daily administrative operations of the Plan. The office prepares operating budgets; maintains financial records, including members' contribution records; and pays benefits.

An executive director is appointed by the board and is the board secretary and chief administrator of the Plan. The executive director is authorized, within budgetary limits, to hire necessary staff other than the chief accountant. The executive director represents the board in meetings with members, city departments, and State and Federal authorities.

This office employs about 90 persons. They are city employees selected in accordance with the city's civil service system.

Chief accountant

The chief accountant is in charge of the Plan's general accounting work and the members' annuity savings accounts, and also serves as the budget officer. He is responsible for preparing and certifying the accuracy of the annual consolidated financial statements, which show the assets, liabilities, and operations of the funds of the fixed, variable, and tax-deferred annuity programs.

The chief accountant, who is appointed by the board, is directly responsible to the executive director for the proper performance of his duties. His reports are submitted to the board through the executive director. Although there are no qualifications requirements for the chief accountant, the executive director said that the incumbent is a certified public accountant.

Comptroller of the city of New York

The comptroller is by law an ex officio member of the board and custodian of Plan funds. The comptroller is authorized, subject to the board's approval, to invest the funds of the fixed annuity program and the fixed portion of the tax-deferred annuity program. (These programs are discussed in the section beginning on p. 48.)

City legislation permits the Plan to delegate its investment powers to the comptroller. According to a Plan official, since 1917 the board--through a resolution which has been renewed every 3 months--has authorized the comptroller to invest the funds of the fixed annuity program and the fixed portion of the tax-deferred annuity program.

Investment Advisory Committee

The comptroller has established an Investment Advisory Committee to advise and assist him in the management of pension funds. The committee is made up of six officials principally from the banking and insurance fields. This committee meets about four times a year to review the general economic situation, including the bond and stock markets, and examine security purchases and sales.

Investing agents

The board has contracted with 10 investing agents to manage the funds of the variable annuity program and the variable portion of the tax-deferred annuity program. The

10 agents consist of 5 local banks, 3 local and 1 out-of-State broker dealer, and 1 out-of-State insurance company. These firms adopt their own investment philosophy within the guidelines of the law and policies of the board. The programs and the investment activities of the 10 investing agents are described in the section beginning on the following page.

Investment advisor

The board has contracted with a local advisory firm to monitor the activities of the investing agents and provide investment advice. Its responsibilities are described in the section beginning on page 53.

MAKING AND IMPLEMENTING INVESTMENT POLICY

The city's Administrative Code gives the board authority to invest and manage the Plan's assets and responsibility for establishing and implementing investment policies. However, the investment of Plan funds is subject to the New York State Banking Law and the Retirement and Social Security Law.

The Administrative Code states that the assets of the variable fund may be invested in stocks which are permissible investments for domestic life insurance companies or savings banks. The investments are subject to the following limitations:

--No more than 5 percent of the Plan's assets shall be invested in the stocks of any corporation and its subsidiaries.

--No more than 2 percent of the total issue and outstanding stocks of any corporation and its subsidiaries shall be owned by the Plan.

The Retirement and Social Security law sets the following limitations on mortgages, stocks, and corporate obligations.

--No more than 30 percent of the Plan's assets may be invested in conventional mortgages, no more than 5 percent may be invested in any mortgage, and no investment of less than $250,000 may be made in a mortgage.

--No more than 10 percent of the Plan's assets may be invested in any conventional mortgage guaranteed by a State bank or trust company.

--No more than 6 percent of the fund in any year or more than 35 percent of the total fund may be invested in stocks of corporations in which investments are permitted under applicable State laws.

--No more than 1.5 percent of the fixed annuity funds may be invested in the stock of any corporation, nor may the Plan own more than 3 percent of the total outstanding shares of any corporation.

In addition, the executive director said that the Plan makes loans to members against their contribution accounts. The Plan does not make loans to State or city officials or governments. However, with the board's prior approval, bonds, notes, and other obligations of State and city governments may be purchased. Such purchases from funds of the fixed annuity program are discussed in the following section.

Investment policy

The board establishes the Plan's investment policy. Investment recommendations made by the comptroller and the 10 investing agents who manage the three annuity programs must be approved by the board before implementation. The board has established the following investment guidelines for the fixed, variable, and tax-deferred annuity programs.

Fixed annuity program

The purpose of this program is to provide members with a fixed dollar annuity upon retirement. The executive director said that the important investment consideration for the fixed annuity funds is safety of investment--a return of 4 percent is guaranteed by the city. If the Plan's investment portfolio earns less than 4 percent per year, the city makes up the difference. Earnings exceeding 4 percent go to the city. Plan earnings have exceeded 4 percent since June 30, 1964. (See ch. 3 for further information on the annual rate of return.)

The comptroller is authorized, subject to prior approval of the board, to invest the fixed annuity funds in any investments authorized by law. The comptroller can invest in (1) obligations of the United States, local governments, and Canada, (2) bonds, notes, mortgages, and other indebtedness of corporations, (3) public utility obligations, and (4) stocks of corporations. According to a Plan official, there is no requirement that a certain portion of the fixed annuity fund's assets be invested in local businesses, or State or city obligations.

The board must approve tax-exempt bonds, such as State or local obligations, before the comptroller can buy them. Purchases of long-term bonds are restricted to at least an "A" rating by major rating agencies such as Moody's or Standard and Poor's. Although the comptroller is authorized to buy corporate stock, subject to the board's approval, the executive director said that the comptroller has made it a practice not to purchase any common stock for the fixed annuity plan.

During fiscal year 1976, the investment of fixed annuity program funds in New York City obligations increased substantially. The increase was reflected primarily in the purchase of bonds of the State's Municipal Assistance Corporation for the city of New York and New York City bonds. These purchases resulted from a November 26, 1975, agreement signed by the Municipal Assistance Corporation, 11 local commercial banks, the city's four sinking funds, and the city's five retirement systems. The Plan agreed to buy $860 million of these obligations, and the other four retirement systems agreed to buy $1.64 billion over a 3-year period.

Investments in city obligations have increased by $447 million--from $165 million on June 30, 1975, to $612 million on May 31, 1976. As of May 31, 1976, the investment in city obligations represented about 31 percent of the fixed annuity plan portfolio of about $2 billion.

Variable annuity program

The purpose of the variable annuity program is to protect the members' retirement income against increases in the cost of living by providing a variable retirement benefit based upon the performance of the portfolio. The investment philosophy is to achieve the best rate of return without endangering capital. The combination of earned income and capital growth is expected to increase each member's invested dollars over a long period.

The board has the authority to invest funds and has selected outside investing agents to manage the funds. The investing agents selected have invested in common stock, preferred stock, convertible bonds, and short-term notes. Over 85 percent of the variable annuity program portfolio is in common stocks.

The board established the following conditions for the investment of variable annuity program funds.

--Securities purchased must be in domestic or comparable Canadian companies.

--Securities purchased--except for securities of banks, trust companies, and insurance companies--must be listed on a national security exchange.

--Companies in which funds are invested must have earned at least 4 percent on the par or stated value of their stock in each of the last 7 fiscal years.

--A company in which funds are invested must have had average earnings--before income taxes--during the last 5 fiscal years, at least equal to 1-1/2 times the total of the company's fixed costs, maximum contingent interest, and preferred dividends. Also, the company must have had earnings during one of the last 2 fiscal years at least equal to 1-1/2 times the total of the company's fixed costs, maximum contingent interest, and preferred dividends.

Investments not meeting the requirements, however, can be purchased provided that the aggregate cost of the investments does not exceed 10 percent of the market value of all the assets calculated at the time of the most recent investment. Also, daily cash balances are to be kept as low as possible. There is no limit on the percentage of variable annuity program funds that can be invested in temporary--1 year or less to maturity--fixed income securities.

Current policy is that long-term bonds as a long-term investment are inconsistent with the objectives of the variable annuity program. However, the board permits investing agents to purchase long-term bonds, as a temporary equity substitute, in the same manner that short-term debt is used. At the time of purchase, the investing agent must intend to hold the long-term bonds as an equity substitute for less than 2 years. The bonds must not exceed 25 percent of the value of assets of the variable annuity program and must have a Moody's or Standard and Poor's rating of at least "A."

The board has set no overall rate-of-return objective. The investing agents have established their own goals, based on their own investment philosophies. However, to obtain a greater rate of return, the executive director said that the board, with the aid of the investment advisor, modifies investment policy to meet current trends. For example, when bond rates were higher than those of commercial paper, the board recommended that agents invest in long-term bonds rather than short-term investments.

Stocks purchased by investing agents must be from a list of companies approved by the board. According to the executive director, under board policy no preferential treatment is given New York City-based companies. The stocks held are primarily in companies that are listed on national stock exchanges.

Tax-deferred annuity program

The purpose of the tax-deferred annuity program is to permit members to direct limited sums toward the purchase of a retirement annuity and to have these sums excluded from current Federal income taxes. Both fixed dollar annuities and variable annuities are available. Each member has the option of allocating one-half or all of his contribution to one of these annuities.

The fixed funds of the tax-deferred annuity program are jointly invested with funds of the fixed annuity program managed by the comptroller. The variable annuity funds of the tax-deferred annuity program are jointly invested with the funds of the variable annuity program managed by the 10 investing agents. Hence, the investment policy of the tax-deferred annuity program is two separate policies, identical to the policies for the fixed and variable annuity programs as discussed previously.

Implementing investment policy

The executive director said that all investments of the comptroller and the investing agents are reviewed by the board at its monthly meetings. The board carries out its responsibility for investing the Plan's assets by establishing the guidelines previously discussed and by overseeing the investments of the comptroller and the 10 investing agents.

The comptroller invests the fixed annuity portion of the Plan's funds in government and corporate bonds and notes and in Federal Housing Administration and conventional mortgages. The comptroller does not have a board-approved list limiting purchases. The minutes for the board's June 1976 meeting, however, showed that the board reviewed and approved the comptroller's investment recommendations. As of June 30, 1975, the comptroller had about $1.8 billion of the Plan's assets under his management. According to the executive director, the comptroller retains physical control of these assets.

The investing agents must invest and administer the variable annuity portion of the Plan's funds in a manner designed to protect the purchasing power of the beneficiaries' retirement income by exercising diligence and care and keeping abreast of conditions. Each agent is required to exercise as much care as a (1) professional fiduciary, (2) a trustee of an express trust under the laws of the State, (3) a fiduciary under the Employee Retirement Income Security Act of 1974, or (4) an investment manager and analyst in the industry.

In carrying out these duties, agents are given authority to buy and sell securities approved by the board, employ brokers, and defend and initiate lawsuits, subject to prior board approval. Agents are expected to segregate and identify those securities held for the board. As of June 30, 1975, Plan assets assigned to the agents totaled about $1 billion. The insurance company and five banks serving as agents for the Plan are permitted to maintain custody of Plan assets. However, the four broker-dealers serving as agents for the Plan are required to have separate custodians for Plan assets.

According to the executive director, the investing agents' investment goals are discussed at the board's monthly investment meetings. The board, along with the investment advisor, reviews performance data on all the agents' activities. The investment advisor makes recommendations concerning their investment goals. Each investing agent is assigned a part of the Plan assets for investment based on the advisor's recommendations.

Experience of the investment decisionmaking staff

The comptroller of the city of New York is elected every 4 years by the city's voters. An advisory committee composed of officials from the banking and insurance fields helps the comptroller manage pension funds.

A Plan official said that, except for one agent, the board selected investing agents based on an evaluation of their experience in managing investment portfolios similar to the variable annuity portion of the Plan's funds. Each prospective investing agent submits information on background, amount of funds managed, the number of investment personnel, relevant performance data, and investment characteristics and philosophy. The board then selects the firm that seems most appropriate to the Plan's investment goals.

In addition, the agent states in its contract that it is an experienced money manager and professional investment analyst and manager; that it has the professional investment skills, knowledge, and experience necessary to invest pension funds; and that it has the professional staff and extensive facilities to do the economic research and other investment analysis necessary for prudent investment decisions.

A Plan official said that the exception involved a broker-dealer who was selected because the board wanted to include an index fund in the overall portfolio and this broker was a pioneer in index funding. Index funds are stock portfolios that attempt to duplicate the stock composition of broad stock market averages, such as Standard and Poor's 500, and thereby duplicate the average return.

According to a Plan official, investing agents were not selected merely because they were located in the city. Firms outside the city were also considered. In fact, he noted that two investing agents are located outside the city. The Plan's agents included (1) an insurance company ranked nationwide in 1975 as the largest in assets and (2) two local banks ranked nationwide in 1975 as the third and fourth largest commercial banks in assets.

Selection of brokers

Since the actual investing of assets is handled outside the Plan by the comptroller and the investing agents, they, and not anyone in the Plan, select brokerage firms to handle portfolio transactions.

MANAGEMENT AND CONTROL OF PENSION PLAN ASSETS

The management and control of Plan assets is the board's responsibility. The board has implemented money management and monitoring procedures to make certain that funds are invested promptly and that investment transactions agree with investment policy.

Money management techniques

According to a Plan official, procedures have been developed to make sure that cash is invested as soon as it is available and that no idle cash is maintained.

A Plan official said the Plan's policy calls for the comptroller to maintain no cash balances in the fixed annuity portion of the Plan's funds. The last audit report by the State Insurance Department described the cash management policy of the comptroller as follows. The Office of the Comptroller prepares a statement of the daily receipts and disbursements and the cash book balance as of the end of the business day for all bank accounts and the five city pension funds. A statement of prospective cash needs is also prepared. The bank balances and prospective encumbrances are submitted each morning to the bank's investment staff, who then invest the excess balances in U.S. Treasury bills.

The policy for the variable annuity portion of the Plan's funds is to keep cash balances as low as possible. A Plan official said the board employs the following techniques to make sure that cash is invested immediately. Cash must be available for investment before 11:00 a.m. on the second business day of each month. The board transfers the cash to the investing agents through bank wire. The agents must receive the funds by 11:30 a.m. for investment that day. Usually, the agents anticipate the incoming cash and make purchases before they receive the money. The official said that this technique guarantees that funds are not idle.

Monitoring investment performance

According to a Plan official, the board has employed a local consulting firm to provide investment advice and to monitor the 10 investing agents. The firm reviews and ranks the agents' performances monthly, quarterly, and annually. The firm also

--studies new investment opportunities,

--defines goals for each agent,

--analyzes and apportions new cash additions to agents,

--maintains a profile of each agent's investment program,

--measures and analyzes the performance of each agent and the total investment program,

--maintains a cost analysis of expenses charged to the variable annuity portion of the fund, and

--monitors excessive buying and selling.

In July 1975 the firm recommended that additional funds made available to an investing agent be automatically reviewed by the board if

--the agent's portfolio of Plan investments exceeds 20 percent of Plan assets and

--the part of the Plan's assets managed by the agent exceeds 10 percent of the agent's total assets for all his accounts.

A P.. official said that the investing agents and the comptroller provide the board with monthly statements summarizing all Plan investment transactions. The chief accountant checks these statements by comparing them to computerized records of broker confirmation notices. The Plan is the only one of the five city pension systems that keeps an independent set of books on the comptroller's transactions based on confirmation notices. In addition, the agents' performances are reviewed regularly at the board's monthly meetings. According to the executive director, the legislative limitations on investments are monitored by the Plan's chief accountant.

Disclosure statements

The Plan does not require board members or employees to file disclosure statements that might reveal possible conflicts of interest. The executive director said he knows of no conflict-of-interest situation and he does not plan to require the filing of disclosure statements.

Each board member is required to take an oath that he will diligently and honestly administer the affairs of the board and that he will not knowingly violate or willfully permit to be violated any applicable laws. In addition, the city Administrative Code provides that, except as prescribed in the law, members and employees of the board are prohibited from having any interest in the gains or profits of any Plan investment.

According to the executive director, conflicts of interest, such as a bank investing agent lending to or investing in other bank customers, are prevented by the terms of the contracts with the agents. The executive director said that, on one occasion, an agent purchased stock being underwritten by a group which included its parent company. The board recognized a possible conflict of interest and revoked the purchase.

AUDIT AND DISCLOSURE
OF INVESTMENT ACTIVITIES

The city Administrative Code makes the Plan subject to the supervision of the New York State Department of Insurance. This department audits the Plan every 5 years. The last completed audit, which covered fiscal years 1963-68, was released in 1971. According to a Plan official, city auditors do not audit the Plan, and city funds are not available to pay for an annual audit by an independent certified public accounting firm.

An official in the comptroller's Division of Pensions said this division is subject to audit by the State insurance department every 5 years. Occasionally, the city's investigation division and the State comptroller make limited audits of the city's five pension systems in their audits of selected functions of the city comptroller's office. In 1974 a certified public accounting firm, at the request of the new city comptroller, audited the investments of the pension systems under his management. This audit was made to verify the accuracy of investment records and the adequacy of related internal controls and procedures.

Scope of audit

The last completed insurance department audit for fiscal years 1963-68 included a review of the financial statements of the Plan, including confirmation of cash in banks, investments in stocks and bonds, and other assets and liabilities. The audit also included a review of compliance with the provisions of the laws governing the Plan. The review of the variable annuity program was limited to the 6-month period ended June 30, 1968, since the program was not started until January 1, 1968. Since the tax-deferred annuity program was not instituted until 1970, it was not included in this audit.

The audit report presented recommendations for tighter accounting controls and improved controls over investment policies. It also included a summary of the Plan operation, benefits payable, and pertinent legislation.

Reports issued on pension plan activities

The board is required by the Administrative Code to publish an annual report, which must be certified by each board member. The report is to show the condition of the various funds and other facts, recommendations, and data that may provide knowledge about the Plan. The report details assets, liabilities, income, expenditures, and investments held.

According to the code, copies of the annual report are provided to the mayor; the board of education; and each superintendent, associate superintendent, and assistant superintendent of schools. The Plan must also file two copies with the State insurance department. In addition, a Plan official said that each municipal library receives a copy and that copies are available to the public upon request.

The board also publishes semiannual reports on the variable annuity and tax-deferred annuity programs. These reports are distributed to participating members. The reports summarize performance and list net assets and investments held. In addition, legislation requires the board to open records of its proceedings to public inspection. All Plan members are also provided a yearly statement on the status of their accounts which shows total contributions, loans outstanding, and annuity values.

CHAPTER 3

INVESTMENT EXPERIENCE

ANNUAL RATE OF RETURN

The annual average rate of return is calculated independently for the fixed and variable annuity funds, including the funds of the fixed and variable portions of the tax-deferred annuity program. Instead of an overall rate of return on plan investments, the Plan presents a separate rate of return for both the fixed and variable annuity portions of the Plan's funds.

The following table shows the rates of return on the Plan's investments. The rates are not comparable because the rates for the fixed annuity portion of the Plan's funds exclude unrealized capital gains and losses, while the variable annuity portion includes both realized and unrealized capital gains and losses as well as dividends and interest income.

Fiscal year	Percent of return: Fixed annuity funds	Percent of return: Variable annuity funds
1971	4.66	13.40
1972	4.77	16.30
1973	5.39	-19.90
1974	6.18	-27.83
1975	6.23	31.31

The rates of return for the fixed annuity funds were calculated by the Plan's staff. A Plan official explained that the book value of each investment, after adjusting for premiums and discounts, is multiplied by the effective yield to arrive at earnable interest. The total earnable interest for the portfolio is then divided by the total book value to arrive at a composite yield for the portfolio. Moreover, for the fixed annuity funds, the city guarantees a 4-percent annual yield. Any amount over the guaranteed yield is used to offset the city's contribution. For example, the fixed annuity funds had a return of 6.23 percent in fiscal year 1975, of which 4 percent (about $72 million) was credited to the individual members' accounts and 2.23 percent (about $36 million) was used to offset the city's contribution.

A Plan official was able to calculate a rate of return of 7.70 percent for 1975 including unrealized capital gains and losses, based on a formula of interest receivable divided by market value of the securities of the fixed portion of the Plan's funds. This calculation reportedly cannot be made for prior years because market values of securities were not available. Also, even the 7.70 rate may have included book value for those securities whose market values were not available because the securities are not traded.

The rates of return on the variable annuity funds were calculated by the firm employed by the Plan to monitor investment activities. The rate was measured on a time-weighted basis and includes both realized and unrealized capital gains and losses as well as dividend and interest income. The rate represents what a dollar at the beginning of a particular period would have earned throughout the full period.

PENSION PLAN ASSETS

The values of Plan assets as shown in the annual statements for fiscal years 1971-75 are as follows:

Fiscal year	Amount
1971	$2,479,508,110
1972	2,608,413,067
1973	2,582,487,047
1974	2,657,853,373
1975	2,995,813,974

A comparison of the Plan's assets by category for the 5-year period is shown in schedule 1 on page 62. During that period, about 85 to 89 percent of the Plan's assets were invested in bonds, stocks, and State and local government securities.

FUNDS IN NON-INTEREST-BEARING ACCOUNTS

The Plan maintains six non-interest-bearing checking accounts in the name of the comptroller as custodian of the funds. These accounts, which are maintained in four banks, include accounts for death benefits, payroll, loans, and sundry expenditures as well as two inactive accounts. One account, although inactive, contains about $55,000 to cover outstanding checks. Plan officials could not explain the purpose of the second account, which contained about $44,000.

As of May 31, 1976, the Plan reported a net negative cash balance of $22,473,978 in these accounts--four accounts had negative balances and the other two had positive balances. Negative cash balances are maintained by using bank "float time." For example, the Plan mails retirement checks at the end of the month, but it does not deposit cash to cover payment until sometime during the next month, thereby taking advantage of the time lag for the checks to clear the bank.

The law provides that an available fund, not exceeding 10 percent of the total amount of the several funds, may be kept on deposit in any bank or trust company of the State if

--the bank or trust company furnishes adequate security for the funds and

--the sum deposited in any bank or trust company does not exceed 25 percent of the paid-up capital and surplus of the bank or trust company.

The following table shows, for the 6-month period December 1975 through May 1976, the average daily balances and monthly expenditures for the six non-interest-bearing accounts discussed above.

Month	Average daily balance	Monthly expenditures
December	$-3,314,701	$694,593,323
January	-4,989,473	486,919,510
February	-5,165,039	557,175,713
March	-6,306,202	755,319,470
April	-5,858,308	585,269,817
May	-5,181,652	500,978,222

OPERATING COSTS

The city Administrative Code provides that the city shall pay the Plan's operating costs for the fixed annuity program. The administrative costs for the variable annuity program are charged against program funds. Members of the tax-deferred annuity program are assessed a monthly fee to cover the program's administrative costs.

The operating costs of the Plan include such administrative expenses as salaries, rent, professional services, office equipment, supplies, and investment agents' fees.

The Plan's yearly operating costs for 1971-75 and a comparison of costs to contributions are shown below.

Fiscal year	Operating costs	Contributions	Operating costs as a percent of contributions
1971	$2,748,074	$273,615,563	1.00
1972	2,723,412	150,980,751	1.80
1973	2,852,701	188,929,947	1.51
1974	2,960,179	386,849,648	0.77
1975	3,028,902	374,509,969	0.81

SCHEDULE 1

THE TEACHERS' RETIREMENT SYSTEM OF THE CITY OF NEW YORK

COMPARATIVE STATEMENT OF ASSETS AS OF

JUNE 30, 1971, 1972, 1973, 1974, AND 1975 (note a)

Assets	1971 Amount	1971 Percent	1972 Amount	1972 Percent	1973 Amount	1973 Percent	1974 Amount	1974 Percent	1975 Amount	1975 Percent
Cash in bank	$ 1,802,768	0.1	$ -19,852,938	-0.8	$ -18,713,088	-0.7	$ -17,921,815	-0.7	$ -16,412,026	-0.6
U.S. Government securities	71,728,626	2.9	50,429,343	1.9	59,069,771	2.2	60,652,979	2.3	74,261,540	2.5
State and local government securities	388,497,541	15.7	354,640,524	13.6	131,111,132	5.1	110,123,155	4.1	110,117,492	3.7
Corporate and other bonds	1,008,447,762	40.7	972,195,970	37.3	1,113,107,850	43.1	1,288,713,856	48.5	1,461,555,932	48.8
Canadian bonds and securities	88,293,149	3.6	91,719,747	3.5	95,756,576	3.7	109,317,455	4.1	108,212,864	3.6
Common and preferred stocks	697,262,812	28.1	901,283,926	34.6	847,182,485	32.8	758,760,648	28.6	895,023,185	29.9
Mortgages	48,470,766	2.0	44,433,709	1.7	41,483,001	1.6	38,405,136	1.4	35,318,404	1.2
Short-term investments	90,326,259	3.5	90,532,061	3.5	133,650,527	5.2	81,284,629	3.1	115,855,495	3.8
Other (note b)	84,678,427	3.4	123,031,725	4.7	179,838,793	7.0	228,517,329	8.6	211,881,085	7.1
Total	$2,479,508,110	100.0	$2,608,413,067	100.0	$2,582,487,047	100.0	$2,657,853,372	100.0	$2,995,813,971	100.0

a/Data obtained from published annual reports for 1971-74 and unpublished financial statements for 1975.

b/Represents a custodial account for investment purposes, receivables, equipment, and miscellaneous investments.

SCHEDULE OF BENEFITS

[Extracts from Fifty-Seventh Annual Report of the Retirement Board, The Teachers' Retirement System of the City of New York, fiscal year ended June 30, 1974.]

A member who elects the twenty year pension plan [see GAO note] may cancel such election at any time in which case he will become eligible to the benefits provided by the age-55-increased-benefits pension plan. No change in plan is permitted to any member who is eligible to the benefits of the age-55-increased-benefits pension plan. In each of these two plans, retirement is mandatory at the end of the school year in which the member attains age 70.

I. SERVICE RETIREMENT

A. Twenty Year Pension Plan - (1) A member who joined prior to July 1, 1973 and who elects the twenty year pension plan is eligible to retire after having completed 20 years of service, with benefits to begin on the payability date. Regardless of the number of years of service, however, such member who has elected the twenty year pension plan and who is at least 55 years of age may retire with benefits payable immediately by cancelling his election of the twenty year pension plan, thereby becoming eligible to the benefits under the age-55-increased-benefits pension plan described below. (2) In order for a member who joins after June 30, 1973 to be eligible for retirement, he must (a) have attained age 55 and (b) have rendered five years of continuous service, in addition to the afore-mentioned requirements.

The service retirement allowance for a member who joins prior to July 1, 1973 is the sum of (1) 50% of average salary, reduced by an annuity which is the actuarial equivalent of the minimum accumulation, (2) a annuity which is the actuarial equivalent of the accumulated deductions, and (3) for years of service in excess of

GAO note: The various retirement options included in this schedule are referred to as plans. Within the case study, we referred to these plans as programs in order to minimize confusion with the term "Plan" which we use in referring to the Teachers' Retirement System of the City of New York.

SCHEDULE 2

20, (a) a pension for increased-take-home-pay which is the actuarial equivalent of the accumulated contributions for increased-take-home-pay made in each such year, and (b) 1.2% of average salary for each such year prior to July 1, 1970 and 1.7% of average salary for each year beginning on that date.

B. Age-55-Increased-Benefits Pension Plan - A member who joins prior to July 1, 1973 and who either elects the age-55-increased-benefits pension plan or who cancels his election of the twenty year pension plan may retire after having attained age 55 with benefits payable immediately upon retirement. The service retirement allowance consists of a pension for service, a pension for increased-take-home-pay, and an annuity. The pension for service is equal to 1.2% of average salary multiplied by each year of service prior to July 1, 1970, plus 1.53% of average salary multiplied by each year of service after June 30, 1970, the pension for increased-take-home-pay is the actuarial equivalent of the reserve for increased-take-home-pay, and the annuity is the actuarial equivalent of the member's accumulated deductions. (2) In order for a member who joins after June 30, 1973 to be eligible for retirement, he must (a) have attained age 55 and (b) have rendered five years of continuous service in addition to the afore-mentioned requirements.

C. Restrictions Imposed by Article 11 - Under both the twenty year pension plan and the age-55-increased-benefits pension plan, in order to be eligible to retire, a member who joins after June 30, 1973 must (1) render five years of continuous service immediately prior to retiring and (2) have attained age 55. Furthermore, if such member retires prior to age 62 with less than 30 years of service, his pension for service is reduced by 0.5% for each of the first 24 months that the payability date precedes age 62, and by 0.25% for each such additional month.

II. ORDINARY DISABILITY RETIREMENT

Regardless of the plan elected, a member who has completed 10 or more years of City service preceding the occurrence of disability for causes other than accident in the actual performance of duty is entitled to an ordinary disability retirement allowance.

If at the time of becoming disabled, the member could have retired for service with benefits payable immediately, the ordinary disability allowance is the same as the service retirement allowance. For all other members, the ordinary disability allowance is computed in the same manner as though the member had been eligible for service retirement under the age-55-increased-benefits pension plan with benefits payable immediately, but never less than the allowance that would have been payable under the provisions in effect prior to July 1, 1970.

III. ACCIDENT DISABILITY RETIREMENT

Upon the occurrence of disability caused by an accident in the actual performance of duty, a member is entitled to an accident disability retirement allowance consisting of a pension equal to three-fourths of average salary in the last five years; a pension for increased-take-home-pay which is the actuarial equivalent of the reserve for increased-take-home-pay; and an annuity purchased with the member's accumulated deductions. The pensions are subject to reduction because of Workmen's Compensation benefits granted on account of the accident.

IV. TERMINATION OF EMPLOYMENT

A member who either resigns or is dismissed from service receives a benefit equal to his accumulated deductions. At resignation with at least 15 years of service, at least 5 of which immediately precede resignation, the member may elect, in lieu of a return of his accumulated deductions, to receive a vested allowance computed in the same manner as the retirement allowance for service retirement under the age-55-increased-benefits pension plan, except that the allowance is deferred to age 55. Should a member who elected to receive a deferred retirement allowance die before the attainment of age 55, the benefit consists of the accumulated deductions and the reserve for increased-take-home-pay.

V. DEATH BENEFIT

Upon the death of a member in active service, a benefit is paid to his estate or to such person as he shall have nominated.

With respect to a member who joined before July 1, 1973, the benefit is equal to the compensation earnable by him in the six months immediately preceding his death. If the total number of years of City service is greater than ten, but less than twenty, the benefit is equal to the compensation earnable by him during the twelve months immediately preceding his death. If the total number of years of City service exceeds twenty, the benefit is equal to twice the compensation earnable by him during the twelve months immediately preceding his death. In addition, the member's accumulated deductions and the reserve for increased-take-home-pay are paid to his estate or to the designated beneficiary.

The benefit payable on account of such a member who at the time of his death would have been eligible for service retirement is either the benefit described above or an amount equal to the reserve on the retirement allowance which would have been payable had he retired on the day before his death, whichever is larger.

A member who joins after June 30, 1973 must choose between the two following death benefits; upon his death, a benefit is paid pursuant to his election.

Death Benefit 1: One month's salary for each year of service up to a maximum of three years' salary. In addition, the member's accumulated deductions are payable. If the member would have been eligible to receive an unreduced retirement allowance at the time of his death, the benefit is the reserve on the retirement allowance which would have been payable had he retired on the day before his death, if greater.

Death Benefit 2: In addition to a refund of the member's accumulated deductions, one year's salary for each year of service up to a maximum of three year's salary after three years of service. The maximum benefit declines after age 60 at the rate of 10% per year, to a minimum of 10% of the benefit in effect at age 60. For members whose attained age upon joining the System was 52, 53 or 54, the maximum benefit is two and one-half, two or one and one-half years' salary respectively. For members whose attained age was between 55 and 64 upon entering the System, the maximum benefit is one year's salary; for those 65 and over, the maximum benefit is $1,000. A benefit is also payable upon death after retirement, which benefit is expressed as a percent of the benefit in force immediately before retirement as follows: If death occurs in the first year after retirement, 50% of such benefit; if death occurs in the second year following retirement, 25%; upon death occurring subsequent, 10%. If retirement occurred after age 60, the minimum death benefit payable after retirement is 10% of the death benefits in force at age 60.

The Rules and Regulations adopted by the Retirement Board in accordance with Chapter 581 of the Laws of 1970 provide that the first $50,000 of each benefit on account of death

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in active service is payable from the group term life insurance plan. Only the amount in excess of $50,000, if any, is payable by the retirement system.

VI. OPTIONS ON RETIREMENT OR DEATH

A member upon retirement may receive his basic retirement allowance payable in monthly installments throughout life with all payments ending at death, or may elect to receive the actuarial equivalent in any one of the following optional forms:

(a) With respect to members who join prior to July 1, 1973, a cash refund allowance under which reduced payments will be made during life with a provision that in case of death before such payments have equaled the present value of the retirement allowance at date of retirement, the balance shall be paid to the designated beneficiary or estate. With respect to members who join after June 30, 1973, this option is only available with respect to the annuity.

(b) With respect to members who join after June 30, 1973, a ten-year (or five-year) certain and life allowance under which reduced payments will be made during life with a provision that in case of death within ten (five) years of retirement, the balance that would have been payable had the member survived for ten (five) years shall be paid to the designated beneficiary or estate.

(c) A joint and survivor allowance under which reduced payments will be made during life with a provision that at the death of the member the same payments or one-half of such payments shall be continued throughout the life of such other person as the member shall have designated.

(d) Such other form of actuarial equivalent as may be certified by the actuary and approved by the Retirement Board. By resolution, the Retirement Board has approved an option under which reduced payments will be made during life with a provision that upon his death, a sum specified by the member at the time of retirement shall be paid to the designated beneficiary or estate.

Upon the death of a member in active service, the beneficiary may elect to receive the actuarial equivalent of the lump sum otherwise payable in one of the following forms:

(a) An annual amount payable for life in monthly installments, all payments ending at death, or

(b) A cash refund allowance under which reduced payments will be made during life with a provision that in case of death before such payments have equalled the lump sum payable upon the member's death, the balance shall be paid to the designated beneficiary or estate.

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[GAO note: In interpreting the preceding benefits, the following definitions are used.]

Accumulated Deductions - The total contributions made by the member to his annuity savings account, with regular and special interest thereon.

Reserve for Increased-Take-Home-Pay - A reserve of 2-1/2%, 5% or 8% of the member's salary, pursuant to the provisions of Section B20-41.1, accumulated with regular and additional interest.

Average Salary - (1) For a member who joined prior to July 1, 1973, salary earnable in the last year of the most recent three-year period during which he held no more than one position, or the average annual salary earnable in any five consecutive years designated by the member. (2) For a member who joined after June 30, 1973, the average salary earned during any three consecutive years which provide the highest average salary. However, if the salary earned during any year included in this three year period exceeds the average of the previous two years by more than twenty percent, the amount in excess of twenty percent is excluded from the computation.

Present Teacher - A teacher in the public schools on August 1, 1917 and certain other specified school and college members.

New Entrant - With minor exceptions, a teacher appointed to the Public Schools after August 1, 1917.

City Service - All service as an employee of the City.

Prior Service - All City service and all teaching and supervisory service in schools not maintained by the City prior to September 16, 1917 for present teachers and, in the case of a new entrant, prior to the date of his appointment.

Payability Date - For members who elected the twenty-year pension plan, the date on which the service retirement allowance begins, which is the latest of (1) the date on which the member retires, (2) the date on which he attains the age of 55 years, or (3) the date on which he could have completed 25 years of City service had he remained active. For all other members the retirement allowance begins on the date of retirement.

Minimum Accumulation - The difference between (1) the amount of normal contributions during the member's first 20 years of City service accumulated with interest to his payability date, and (2) the amount of the reserve for increased-take-home-pay on the date such period of 20 years was completed.