REPORT

of the

PENSION ADVISORY WORKING GROUP

To the

GENERAL ASSEMBLY

and

GOVERNOR DANIEL J. McKEE

at its

JANUARY SESSION, 2024

To the Honorable Daniel J. McKee, the Honorable K. Joseph Shekarchi, the Honorable Dominick Ruggerio, and Members of the General Assembly:

The Rhode Island Pension Advisory Working Group has completed its work and respectfully submits the following Report in accordance with R.I. Gen. Laws § 36-10.2-11 (the "Report").

As set forth in the General Laws, this Working Group was asked to "review and analy[ze] the impacts of the Rhode Island Retirement Security Act of 2011 on the state's public retirement system and their current and retired members." R.I. Gen. Laws § 36-10.2-11 (a).

Consistent with the legislative charge, this Report presents "options for consideration" by the General Assembly. *Id.* The Working Group does not opine as to whether a particular option will "improve pension programs or address any unintended consequences" of the Rhode Island Retirement Security Act of 2011 ("RIRSA"). *Id.* Rather, this Report provides the General Assembly with the information necessary to make that judgment. All options contained in this Report were proposed in written or oral testimony to the Working Group at one of its six public hearings. To facilitate a thorough and transparent review of RIRSA, the Working Group presents *every* option that was proposed.

General Treasurer James A. Diossa organized the Working Group on November 2, 2023. The Working Group held a total of six meetings over the course of four months. The Working Group made a thorough study and impartial assessment of the 2011 reforms. In the course of its assessment, the Working Group reviewed source documents from 2011, actuarial data, and academic studies and solicited testimony from members of the Office of the General Treasurer, actuarial professionals, public sector unions, state and national organizations interested in pension reform and sustainability, financial and investment professionals, advocacy groups, and active and retired members of the Employees' Retirement System of Rhode Island.

This Report is the culmination of the Working Group's efforts.

Respectfully,

The Rhode Island Pension Advisory Working Group

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George Nee, Co-Chair

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EXECUTIVE SUMMARY

Just over a decade ago, the Rhode Island General Assembly enacted a series of comprehensive pension reforms known as the Rhode Island Retirement Security Act of 2011 ("RIRSA") to address the public pension fund's large, unfunded liability and "ensure the sustainability of the state's public retirement systems." Pub. L. 2011, Ch. 408, § 1. As of 2010, the unfunded liability for the Employees' Retirement System of Rhode Island ("ERSRI") was approximately $7 billion, with just a 48.4% combined funded ratio (representing the percent of the retirement system's actuarial liability that is covered by assets). *See id.*

RIRSA sought to foster long-term fiscal stability and retirement security in Rhode Island through sweeping changes to the state's benefits structure. Among other reforms, RIRSA:

(1) Froze pensioner cost-of-living adjustments ("COLAs") until the collective funded status of ERSRI, the State Police Retirement Benefits Trust ("SPRBT"), and the Rhode Island Judicial Retirement Fund Trust ("RIJRFT") reaches 80%; and
(2) Replaced participants' traditional defined-benefit ("DB") pension plan with a hybrid model, comprised of a more limited DB plan and a new defined-contribution ("DC") plan.

See id. In the years since reform, the state's pension system is on more sound fiscal footing. The combined funded ratio has increased by 14.4 percentage points, from 48.4% to 62.8% and state and municipal contribution rates have been stable and affordable relative to 2011 projections.

The 2011 reforms were intended to protect the integrity of the pension fund. However, it is quite clear that the reforms have had a negative financial impact on state employees and retirees. Though the General Assembly understood the reform would have negative consequences, those impacts have been amplified by unexpected intervening events. Specifically, the interplay between the 2011 reform, unusually high inflation rates, and shifts in employee decision-making.

In undertaking a review of the state pension system in 1971, a Special Legislative Commission recognized that "[e]ver-changing economic and social patterns directly affect pension policies and pension standards. These changes give rise to recurring proposals for revising existing retirement plans in public administration." Final Report of the Special Legislative Commission to Study the Employees Retirement System in Rhode Island, at 1 (Feb. 1970). Pension systems, like other public policy matters of "broad content and application, seldom remain[ ] static." *Id.* "Current economic trends, the introduction of new and unforeseen factors," and "a multitude of other factors make the entire subject one requiring constant re-evaluation and analysis." *Id.*

In that same spirit, the General Assembly passed a law during the 2023 legislative session instructing General Treasurer James A. Diossa to establish and convene a Pension Advisory Working Group (the "Working Group"). *See* R.I. Gen. Laws § 36-10.2-11. The enabling legislation directed the Working Group to review and assess the impact of RIRSA on "current and retired members" of ERSRI. *Id.*

Throughout this process, both the Working Group and the Office of the General Treasurer have made great efforts to ensure the review process is as thorough, inclusive, and transparent as possible.

Over the course of six televised hearings open to the public, the Working Group considered voluminous written and oral testimony concerning the potential impacts and unintended consequences of RIRSA and options witnesses contend are needed to improve the state pension system. Collectively, the Working Group heard testimony from over 160 members of the public and 26 different stakeholder groups representing both active and retired members of ERSRI and the Municipal Employees' Retirement System ("MERS"), state and national organizations interested in pension reform and sustainability, financial and investment professionals, and state and municipal employers.

Consistent with its statutory mandate, this Report assesses "options for consideration" by the General Assembly. *See* R.I. Gen. Laws § 36-10.2-11. To facilitate a thorough and transparent review of RIRSA, the Working Group presents *every* option that was proposed. But the Working Group does not opine as to whether a particular option will "improve pension programs or address any unintended consequences" of RIRSA. *Id.* Rather, this Report provides the General Assembly with the information necessary to make a considered judgment.

The enabling statute also obliged the Working Group to provide a complete overview of potential cost implications. *See id*. ("Options, to the extent possible, shall include a clear cost-benefit analysis."). To fulfill that legislative charge, this Report provides a complete actuarial cost assessment for each option considered. It also analyzes several cost considerations that may be associated with legislative change to the pension system, depending on the nature, extent, and funding method of any such change. Whether a particular option is feasible and affordable – and the means through which a particular option is funded – is not addressed, since it is outside of the scope of the Working Group's statutory authority.

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INTRODUCTION

I. ORGANIZATION AND BACKGROUND OF THE WORKING GROUP

A. *Statutory Authority*

During the 2023 legislative session, the General Assembly passed legislation instructing the General Treasurer to "establish and convene" the Working Group to review and assess the impact of the RIRSA reforms on "current and retired members" of ERSRI. R.I. Gen. Laws § 36-10.2-11. The legislature instructed the Working Group to "develop options for consideration" by the General Assembly "to improve pension programs or address any unintended consequences" of RIRSA. *Id.* To the extent feasible, the legislature requested the Working Group provide a "clear cost-benefit analysis" of options presented. *Id.*

B. *Membership of the Working Group*

In the enabling act, the General Assembly authorized the General Treasurer to "establish and convene" the Working Group. R.I. Gen. Laws § 36-10.2-11. While the enabling act did not require a specific composition, it provided guidance to the General Treasurer in convening the Group. Specifically, the legislation suggested the Working Group include designees from "the office of the [G]eneral [T]reasurer, actuarial professionals, private sector unions, state and/or national organizations interested in pension reform and sustainability, pension advocacy groups and financial and investment professionals." *Id*. Consistent with that mandate, the General Treasurer convened the Working Group on November 2, 2023, representing the constituencies described in the enabling act. The Working Group was comprised of the following members:

(1) **Michael DiBiase** – Co-Chair of the Working Group and President and CEO of the Rhode Island Public Expenditure Council.
(2) **George Nee** – Co-Chair of the Working Group and President of the Rhode Island AFL-CIO.
(3) **Ernie Almonte, CPA, CGFM, CGMA, CFF** – President of the Rhode Island League of Cities and Towns.
(4) **Eric Atwater, FSA, EA, MAAA** – Professional actuary and Partner, Aon PLC.
(5) **Patrick Crowley** – Secretary Treasurer of the Rhode Island AFL-CIO.
(6) **Thomas Huestis** – Senior Managing Director of the Public Resources Advisory Group.
(7) **John P. Maguire** – Active Teacher Representative, Employees' Retirement System of Rhode Island Board Member and retired member of ERSRI.
(8) **Dr. Laura Quinby, Ph.D.** – Senior Research Economist at the Center for Retirement Research at Boston College.
(9) **Edinaldo Tebaldi, Ph.D.** – Professor of Mathematics and Economics and Director of Strategic Planning & Institutional Effectiveness at Bryant University.
(10) **Jonathan Womer** – Director of the Rhode Island Department of Administration.

While the Office of the General Treasurer did not have a staff-member on the Working Group itself, Treasury staff were actively engaged and helped facilitate the review process.

C. *Hearings*

The Working Group designed and undertook a comprehensive review of the 2011 reforms that engaged both experts and members of the public. Over the course of six public hearings, the Working Group heard extensive testimony from actuarial professionals, state and national organizations interested in pension reform and sustainability, pension advocacy groups, financial and investment professionals, active member union representatives, municipalities, state and municipal employers, retired state and municipal employees, and members of the public, including but not limited to representatives of:

Gabriel, Roeder, Smith
New England Pension Consultants
Public Resources Advisory Group
The Rhode Island Federation of Teachers and Health Care Professionals
The Coventry Teachers' Alliance Local 1075
The Rhode Island State Association of Firefighters
The International Brotherhood of Police Officers
Service Employees International Union Local 580
Service Employees International Union Local 401
The American Federation of State, County and Municipal Employees Council 94
AFSCME Local 528
National Education Association Rhode Island
United Nurses and Allied Professionals
The International Federation of Professional and Technical Engineers Local 400
The Rhode Island Federation of Teachers/Retirees, Local #8037R
National Education Association Rhode Island Retirees
AFSCME Rhode Island Retirees Council 94
The Rhode Island Police Chiefs' Association
The Rhode Island Fire Chiefs' Association
The Rhode Island School Superintendents Association
The Policy Lab at Brown University
The Center for Retirement Research at Boston College
The Office of the General Treasurer
The Rhode Island League of Cities and Towns
Pew Charitable Trust
The National Institute on Retirement Security

Several other organizations were invited but declined the opportunity to participate. The Working Group also considered written and oral testimony from over 160 members of the public, including several retiree groups representing those impacted by the 2011 reforms. All documentary evidence and written testimony submitted to the Working Group during this process is publicly posted and available on the General Treasurer's website. *See* Office of the General Treasurer, *Pension Advisory Working Group*, accessed Feb. 14, 2024, at https://treasury.ri.gov/pension-advisory-working-group.

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

II. DISCLAIMERS

A. *Options Requested for Consideration*

Consistent with the legislative charge, this Report presents "options for consideration" by the General Assembly. The Working Group does not opine as to whether a particular option will "improve pension programs or address any unintended consequences" of RIRSA. R.I. Gen. Laws § 36-10.2-11. Rather, this Report provides the General Assembly with the information necessary to make a considered judgment. All options contained in this Report were proposed in written or oral testimony to the Working Group at one of its six public hearings. To facilitate a thorough and transparent review of RIRSA, the Working Group considered *every* option that was proposed.

The options assessed herein do not constitute recommendations of the Working Group, or of the Office of the General Treasurer.

B. *Order of Presentation*

Options are presented and grouped topically. Order should not be construed as a preference of the Working Group or of the Office of the General Treasurer.

C. *Costs Considered Independently*

This Report presents the actuarially determined cost for each individual option. However, the actuarially determined cost of multiple options will have a different impact when combined, depending on how the combination of those options influence the behavior of active and retired members of ERSRI.

For example, this Report assesses the cost associated with various provisions which would allow teachers, state employees, or municipal employees to retire earlier than they are able to under the current statutory construction. The Report likewise assesses the cost associated with various benefit enhancements that would result in a higher retirement benefit. As presented herein, each of these proposals is assessed as if it is the *only* change to the system. Were the legislature to consider both proposals, however, the impact would not simply be the cost associated with decreased retirement age plus the cost associated with the increased benefit, since the increased benefit calculation *assumes* the retirement age remains unchanged. But an employee that retires earlier will receive a retirement benefit for a longer period, thereby increasing the collective cost of both options.

III. ON COST

This Section presents an overview of costs that may be associated with legislative change implementing any of the benefit enhancements contained in this Report. This Section is not intended to deter legislative action, but to inform it. Many of these costs are indirect. As decision-makers consider whether to implement changes and if so, what changes to implement, the enabling legislation obliged this Group to provide a complete overview of potential cost implications. *See* R.I. Gen. Laws § 36-10.2-11.

ACTUARIAL COST

Actuary Joseph Newton of Gabriel, Roeder, Smith presented the actuarially determined cost of each option to the Working Group at its January 31, 2024 hearing. His professional assessment gave due consideration to cost, feasibility, and equity of each option. The Working Group had ample opportunity to vet cost estimates at and following the January 31, 2024 hearing. Cost is represented as a change to normal cost, or to the Unfunded Actuarial Accrued Liability ("UAAL"). *See* Index, *infra*. Pursuant to state law, any actuarial gains and losses occurring within a plan year must "be amortized over individual new twenty (20) year closed periods." R.I. Gen. Laws §§ 36-10-2.1, 45-21-43.1. Over the course of this payment period, annual costs increase as state payroll increases (given that the normal cost and contribution rate are expressed as a percent of payroll, and not fixed amounts). The state actuary projects that costs will increase by approximately 2.5% annually during the amortization period. To estimate the total dollar cost over the next 20 years, the Fiscal Year 2025 cost estimate can be multiplied by approximately 25 to account for payroll growth.

For consistency and ease of comparison, effective dates for each of the options assessed in this Report are assumed to be July 1, 2024 – the beginning of Fiscal Year 2025. A different effective date may have an impact on the cost of an option.

ADMINISTRATIVE COST

In addition to actuarial costs, many of these options carry administrative costs necessary to implement the change. The Office of the General Treasurer processes retirement benefits with the aid of software programmed and provided by a third party. While some of the changes could be processed using current software capabilities, others would require new programming. Precise administrative costs would be inherently linked to the complexity of any change. As a guide, however, the Office of the General Treasurer estimates that the information technology changes necessary to implement the 2011 reforms would cost approximately $210,000 to implement today. This cost comes from programming, vendor testing, and ERSRI staff testing and training.

FUNDING COST THROUGH THE PENSION SYSTEM

ERSRI presently has approximately $10.8 billion in assets. When considering whether to enhance benefits for active or retired members of ERSRI – and how to fund any benefit enhancement – decision-makers may suggest the cost be borne by ERSRI. This would, of course, negatively impact the funded ratio and potentially delay the return of long-awaited COLAs (depending on the change). But it is likewise important to recognize that any change – whether it is paid upfront, paid annually through general revenue, or paid from the trust itself – ultimately increases the share of the state budget allocated to funding the pension system under current funding rules.

The State and local share of the pension system (both ERSRI and MERS) is paid through the contribution rate, expressed as a percentage of employee covered payroll. The contribution rate is calculated by actuarial valuation, based on a statutorily mandated funding policy, that ensures the state satisfies the annual required contribution ("ARC") in a given year. Decades ago, the state's repeated failure to make the ARC partially created the unfunded liability that necessitated reform in 2011.

When an additional benefit is paid from the trust and not funded by the legislature, it increases the UAAL. To adjust for this change, and ensure the state continues to meet the ARC in light of the benefit enhancement, the actuarial valuation performed annually at both the state and local levels will adjust the contribution rate.[2] As the contribution rate increases, so do employer costs. Employers will thus be required to contribute a larger share as a percentage of employee payroll to account for the change to the UAAL. This will have a budgetary impact on both the state and on municipalities since municipalities carry the cost of funding the MERS plans and bear 60% of the required contribution for teachers.

This Group does not opine on whether it is advisable to fund pension changes through the budget or from the trust but provides this assessment for consideration by the General Assembly.

STATE DEBT AND THE COST OF BORROWING

To the extent any change to the pension system negatively impacts Rhode Island's credit rating, the Working Group considered testimony that it will impact the cost of borrowing and may impact the economic feasibility of future bond proposals to fund general infrastructure projects, housing development, school construction and other programs. The state's financial advisors – the Public Resources Advisory Group ("PRAG") – testified that ratings agencies generally have a favorable view of Rhode Island in the past several years. At present, Rhode Island maintains an 'AA' general obligation bond rating from both Fitch Ratings and Standard & Poor's. *See* Fitch Ratings, Fitch Rates Rhode Island's $147MM GOs 'AA'; Revises Outlook to Positive, at 1 (Oct. 13, 2023) (hereinafter "Fitch Ratings"); Standard and Poor's, Rhode Island; Appropriations; General Obligation; Moral Obligation, at 2 (Oct. 12, 2023) (hereinafter "S&P"). This year, Fitch Ratings revised its Rating Outlook to "Positive from Stable." *Id*. at 1. The state maintains an Aa2 issuer rating and a stable outlook from Moody's Investors Service. *See* Moody's Investor Service, Rating

[2] The employee contribution rate is determined by statute and cannot be increased in response to a benefit enhancement absent legislative action.

Action: Moody's assigns Aa2 to Rhode Island's GO bonds; outlook stable, at 1 (Oct. 12, 2023) (hereinafter "Moody's").

However, the state's financial advisors indicated that each agency consistently emphasizes Rhode Island's weak economy and demographics, both of which constrain the state's ability to increase its rating from present levels. In published ratings reports, ratings agencies routinely signal that long-term weaknesses in the funded status of the state pension system are an important factor in their ratings. Fitch Ratings cautioned that the state's outstanding pension liabilities continue to dominate its long-term liabilities. Despite Rhode Island's pension obligations, Fitch concluded that "[p]ensions stabilized following statutory benefit and assumption changes a decade ago that were validated in court." *See* Fitch Ratings, at 1-2. Indeed, testimony before the Working Group emphasized that "growing financial relief from pension changes enacted more than a decade ago" has had a marked influence in Fitch's decision to upgrade the state's outlook. *Id*. at 1-2.

S&P likewise finds confidence in past "reforms to reduce the state's unfunded postretirement liabilities and sustain pension funding progress." *See* S&P, at 3. But S&P tempers this optimism with reference to historically weak pension funding discipline and low funding levels. *See id.* at 4. While noting the "improved overall pension funded ratio" at the conclusion of fiscal year 2021, S&P considers the funded status "as relatively low, but improving." *See id*., at 3-4. To improve Rhode Island's core economic metrics, S&P counseled continued fiscal discipline in pension administration, which would likely merit positive rating action. *See id*., at 4-5.

When Rhode Island's ratings are compared to its peers, data suggests states with unaddressed pension challenges generally have less favorable ratings. The Working Group heard testimony from The Pew Charitable Trusts suggesting a correlation between lower-funded pension plans and lower ratings and is evidence that pension health remains an important consideration in a state's credit outlook. *See* David Draine, Testimony before the January 17, 2024 Hearing of the Pension Advisory Working Group, The Pew Charitable Trusts.

The pension system is intended to provide a stable, livable retirement for Rhode Island's public servants. However, testimony before the Working Group acknowledged that the state's rating can have considerable budgetary implications. Should any reform negatively impact the state's credit rating, the state's financial advisors cautioned it could:

(1) Take the state a long time to re-establish its current rating; and
(2) Impact the cost of borrowing going forward, making it more expensive to pay the debt service on state bonds.[3]

This can potentially impact the economic feasibility of projects financed by state bonds, such as housing, green energy, and infrastructure. *See* Tom Huestis, Testimony before the November 2, 2023 Hearing of the Pension Advisory Working Group, PRAG. Whether – and the extent to which – a change impacts the state's bond rating depends on how that change is funded. *See id.* For

[3] Negative credit action would impact municipal borrowing as well, since many of the municipal and quasi-state issuers' ratings are based on the state's rating. This would mean the cost of capital for municipal building projects – such as school construction – would be higher.

example, if the state enhances benefits and re-amortizes the debt over a longer period of time – so that current contribution levels remain unchanged – testimony from the state's financial advisors and the state actuary indicated it would present a considerable concern to a ratings agency. But if the state enhances benefits *and* increases contributions accordingly, ratings are less likely to change.

MUNICIPAL COST

To the extent a change to ERSRI impacts teacher benefits, these changes will also represent increased costs to all municipalities, irrespective of whether they participate in MERS. In addition to any benefits to municipal employees and public safety professionals, municipalities are responsible for 60% of the cost of teachers' pension benefits (funded through the contribution rate). R.I. Gen. Laws § 16-16-20 (the contribution rate "shall be paid forty percent (40%) by the state and sixty percent (60%) by the city, town, [or] local educational agency"). The cost to each municipality will need to be separately determined to fully assess the impact on the municipality's credit rating and possible breach of any debt covenants.

IV. THE RETIREMENT SYSTEM IN RHODE ISLAND

Membership of the Employees' Retirement System of Rhode Island includes all present and former state employees and public school teachers in the State of Rhode Island, with certain minor exceptions specified in law. A parallel system, the Municipal Employees' Retirement System is separately administered but collectively invested by the Office of the General Treasurer. Cities and towns must opt into MERS participation. Presently, MERS administers 122 local pension plans representing most of Rhode Island's 39 cities and towns. *See* Report of the Advisory Council for Locally Administered Pension Plans, Apr. 25, 2023, at 3. Fourteen municipalities independently manage some portion of their local pension plan. *Id.* at 2.

Collectively, ERSRI and MERS provide a complete schedule of benefits for eligible members and beneficiaries, for service retirement, and in cases of disability or death. In many instances – but not all – these benefits are supplemented by federal social security provisions.[4]

As of June 30, 2023, there were 10,959 state employees and 13,554 teachers included as contributing members of ERSRI. There were 8,161 municipal and public safety professionals included as contributing members of MERS units.

As of that same date, there were 11,328 state employees, 11,595 teachers, and 6,755 municipal employees and public safety professionals listed as retirees, pensioners, or beneficiaries. Of those, 18,710 retired before July 1, 2012 – the effective date of RIRSA. A complete breakdown of membership statistics can be found in the June 30, 2023, ERSRI and MERS Actuarial Valuation Reports, attached as appendices to this Report.

[4] Teachers in about half of Rhode Island's municipalities and several public safety units in MERS are not offered Social Security, as discussed *infra* at 28.

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

V. RHODE ISLAND RETIREMENT SECURITY ACT OF 2011

As introduced in October 2011, RIRSA proposed five major reforms intended to chart a path toward long-term sustainability for Rhode Island's pension system. The RIRSA:

(1) Suspended COLAs until the collective funded ratio of the state pension system reached 80%, and instead replaced the annual COLA with an adjustment once every five years (subsequently amended to one every four years, following a 2015 settlement and legislative action);[5]
(2) Created a new DC pension plan to work in tandem with the State's traditional DB pension plan;[6]
(3) Increased the retirement age for current employees to Social Security age thresholds;[7]
(4) Extended the amortization period from 19 to 25 years to make payments toward the unfunded liability more palatable to taxpayers and more sustainable for the state budget;[8] and
(5) Crafted a framework to help municipalities reign in unfunded pension liabilities. *See* 2011-S 1111a.[9]

RIRSA was not the first pension reform effort undertaken by the General Assembly in the 21st century. Indeed, RIRSA was preceded by two partial reform efforts, one in 2005 and one in 2009. While legislative efforts continue to impact members of the retirement system, the legislative act that created the Working Group and defined its charge directed the Working Group to assess the impacts of the 2011 reforms specifically. As such, a further summary of RIRSA provides context for this Report and the Working Group's efforts.

A. *Suspension of Annual COLAs*

RIRSA suspended COLA payments until the aggregate funded ratio for ERSRI, SPRBT, and RIJRFT reaches an 80% funded ratio. Under the new law, pensioners received an adjustment every five years – subsequently amended to every four years by the legislature following a 2015 legal settlement – based on a statutory formula that directly corresponds to investment performance and inflation. *See* R.I. Gen. Laws §§ 16-16-40 (f); 36-10-35 (h); 45-21-52 (i).[10] Before pension reform,

[5] *See* R.I. Gen. Laws § 36-10-35(g)(1) (concerning state employees but replicated in Titles 16 and 45)
[6] *See* R.I. Gen. Laws § 36-10.3-1, *et seq.*
[7] *See* R.I. Gen. Laws § 36-10-9(c)(ii) (concerning state employees but replicated in Titles 16 and 45); 2011-S 1111a, at *17-18 (RIRSA)
[8] *See* R.I. Gen. Laws § 36-10-2.1 (decreasing the amortization period from 30 years to 20 years); 2011-S 1111a, at *14 (RIRSA)
[9] This framework created the Advisory Council to Locally Administered Pension Plans and the Locally Administered Pension Plan Study Commission. *See* R.I. Gen. Laws § 36-10.2-1, *et seq.*
[10] Legislation passed during the 2023 legislative session repealed the four-year COLA, instead creating a 'quarter COLA.' This statute provides pensioners one-fourth of a COLA each year based on the same statutory formula. *See* R.I. Gen. Laws § 16-16-40 (g); 36-10-35 (i); 45-21-52 (j). Both the new quarter COLA and the four-year COLA are calculated based partially on the consumer price index and partially on a 5-year average investment return, with a maximum of 3.5% and a minimum of 0%. Outcomes have been varied over the past decade, since the five-year investment performance average used to calculate COLA size is heavily influenced by investment performance in the final months of the 5-year lookback period. Consequently, there was no COLA in 2016 and a relatively small adjustment in 2020.

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"[r]etirees received a [COLA] tied to inflation and capped at 3[%] of the first $35,000 of their pensions; in other words, up to $1,050 per year." Robert Hiltonsmith, *Rhode Island's New Hybrid Pension Plan Will Cost the State More While Reducing Retiree Benefits*, Economic Policy Institute Issue Brief #366, at 2 (June 20, 2013); 2011-S 1111a.[11]

B. *Hybrid Defined-Benefit, Defined-Contribution Plan*

Perhaps the most significant and enduring of RIRSA's reforms replaced pensioners' traditional DB pension plan with a new hybrid system, comprised of a more limited DB plan and a new DC plan. This reform aimed "to reduce defined-benefit liabilities with a DC fund while also maintaining support from union groups who desire the security of a DB system." Randazzo, *Pension Reform Case Study: Rhode Island*, *supra*, at *18.

Following reform, employees are automatically enrolled in a DC account administered by TIAA and are given a number of investment options. Employees must contribute 5% of their base salary and employers (i.e., the state) must contribute 1%. *See* Gabriel Roeder Smith & Company, Rhode Island Retirement Security Act of 2011: Plan Details, at *2 (October 2011).

The employer contribution rates as a percent of payroll for the DB plan for fiscal year 2023 are 28.01% for state employees, 26.16% for Teachers, 24.16% for Judges, and 20.87% for State Police. *See* ERSRI Audit Fiscal Year Ended June 30, 2022, at 11. Employers contribute 1% to the DC plan by statute (3% for teachers or MERS non-police or fire employees not covered by Social Security). *See* RI 401(a) Adoption Agreement, executed Jun. 29, 2012. By statute, employees contribute 5% of their annual salary to the DC plan. *See* ERSRI Audit Fiscal Year Ended June 30, 2022, at 11; RI 401(a) Adoption Agreement, executed Jun. 29, 2012. Employers and employees in systems not covered by Social Security must each contribute 2% more to the DC plan. *See* ERSRI Audit Fiscal Year Ended June 30, 2022, at 27; RI 401(a) Adoption Agreement, executed Jun. 29, 2012.

Before the 2011 reform, state employees and teachers contributed 8.75% and 9.5% of their respective salaries to the DB fund. *See* Gabriel Roeder Smith & Company, Rhode Island Retirement Security Act of 2011: Plan Details, at *2 (October 2011). The legislature reduced employee contribution rates to the DB plan by the contribution rates to the new DC plan so the employee contribution rates to the new hybrid plan remained constant with prior contribution rates.

C. *Retirement Age*

RIRSA raised the normal retirement age for receiving a full pension to match the Social Security normal retirement age (then 67 years of age). *See Hiltonsmith*, *supra*, at 3. The 'Rule of 95' is an "alternative full benefit retirement eligibility date," which allows members to retire earlier than their schedule-based eligibility date.[12] *Id*. "Under the Rule of 95, members can retire when their age plus their years of service equal 95 provided that they are at least 62 years old." *Id.* Prior to

[11] The inflation-linked COLA was a product of the 2005 reforms. *See* Pub. L. 2005, Ch. 117, Art. 7. COLAs were limited to the first $35,000 of a pensioner's benefit in the 2009 reforms. *See* Pub. L. 2009, Ch. 68, Art. 7.
[12] Employees' Retirement System of Rhode Island, *Retirement Eligibility Rules, Eligibility based on the Rule of 95*, accessed Aug. 25, 2023, at Retirement Eligibility | ERSRI.

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RIRSA, teachers and state employees could retire with full benefits at the age of 65 with 10 years of service, or at the age of 62 with 29 years of service. *See* Gabriel Roeder Smith & Company, Rhode Island Retirement Security Act of 2011: Plan Details, at *2 (October 2011).

D. *Amortization Period*

The RIRSA extended the amortization period from 19 to 25 years to "smooth out the unfunded liability so that taxpayer payments needed to ensure solvency would be easier for the state budget to handle." Randazzo, *Pension Reform Case Study: Rhode Island*, *supra*, at 19. It further required that any actuarial gains and losses occurring within a plan year "be amortized over individual new twenty (20) year closed periods." *See* R.I. Gen. Laws §§ 36-10-2.1, 45-21-43.1.

E. *Municipal Pension Reform*

As part of the RIRSA reforms, the General Assembly passed the "Pathway to Retirement Security for Locally Administered Pension Funds Act" to "promote the sustainability and longevity of pension plans established and administered by municipalities." R.I. Gen. Laws § 45-65-2. By its express language, the statute aims to:

(1) Preserve a reasonable and affordable level of pension benefits;
(2) Avoid "significant and unanticipated retirement benefit deductions";
(3) Avoid diversion of resources to satisfy pension obligations;
(4) Prevent the financial downgrade of municipal bond ratings;
(5) Encourage ratings agencies "to take positive credit actions on Rhode Island municipal bonds"; and
(6) Foster economic growth and financial stability in Rhode Island.

R.I. Gen. Laws § 45-65-3 (3). To accomplish that goal, the statute authorized the creation of a 14-member study commission (the "Commission") and a five-member "advisory council" (the "Advisory Council"). *See* R.I. Gen. Laws §§ 45-65-8, 45-65-10 (a). The Commission was created to "review existing legislation and pension plan administrative practices and to make recommendations for the improved security and funding of locally administered plans and other post-retirement benefit obligations of cities and towns." R.I. Gen. Laws § 45-65-8. The Commission issued a comprehensive report on January 9, 2015.

State law requires the Advisory Council to furnish an annual report by April 30 of each year that includes an assessment of the fund performance, funded status, administrative costs, assumed rate of return, and budgetary capacity for each locally administered pension plan. *See* R.I. Gen. Laws § 45-65-10 (b). As Chairperson, the General Treasurer is further obligated to include "an opinion . . . regarding the sustainability of each plan and any potential areas of concern." R.I. Gen. Laws § 45-65-10 (d). The Advisory Council completed its most recent study in late April of 2023.

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VI. UNINTENDED CONSEQUENCES AND IMPACTS OF THE 2011 REFORMS

The General Assembly directed the Working Group to identify options for consideration by the legislature that may be needed to address – *inter alia* – any "unintended consequences" of RIRSA. R.I. Gen. Laws § 36-10.2-11. There is some disagreement as to whether certain outcomes were unintended – versus intended – consequences of reform. As such, the Working Group looks to the original legislative findings in the preamble to the 2011 reforms for some indicia of intent.

In enacting RIRSA, the General Assembly expressly found that Rhode Island's pension system had reached an "emergency stage" due to critical underfunding and unaffordable government contributions that endangered the pension security of public employees. Pub. L. 2011, Ch. 408, § 1.

"The largest portion of the retirement system," ERSRI, was "funded at a level of 48%" in 2011. *Id.* The legislature found this "well below benchmarks for a viable, sustainable, and adequately funded system," and declared that Rhode Island's pension system was "one of the lowest funded and most vulnerable statewide pension systems in the country." *Id.*

The legislature further found the state was imperiled by "growing and substantial unfunded pension liabilities." *Id.* As measured by "well-established and accepted public accounting standards," the state's unfunded liability exceeded "$7 billion." *Id.* Such critical underfunding "threaten[ed] the base pensions of current and future public workers, hamper[ed] the ability of the state to provide its citizens with vital services necessary for the public's health, safety and welfare, and place[ed] an unsustainable financial burden on *all* Rhode Island citizens and taxpayers." *Id.* (emphasis added).

Absent "immediate and comprehensive legislative action," the General Assembly found the then-existing system would soon become unaffordable. *Id.* Government contributions to ERSRI had "more than doubled between fiscal years 2005 and 2011" and were "estimated to double again in fiscal year 2013 to exceed over $600 million." *Id.*[13] The legislature predicted the state's contribution would continue to rise and would soon "exceed $1 billion dollars" annually. *Id.* The astonishing "cost of current and future benefits" would jeopardize "the pension security of our valued public employees," impact the state's credit rating, and impede the "state's ability to address critical infrastructure needs for education, transportation and other crucial public projects." *Id.*

"To advance and maintain the long-term stability of the public pension programs sponsored by the State of Rhode Island and its municipalities," the legislature declared the "looming pension crisis" must be addressed "without delay." *Id.* Though recognizing the "impact" RIRSA "might have upon the expectations of active and retired members of the affected pension systems as to potential

[13] A contemporaneous valuation performed by ERSRI determined the employer contribution rate (the state payments to maintain the current benefits package, expressed as a percent of employee payroll) to be 35.25% for teachers, and 36.34% for state employees (compared with 22.32% for teachers and 22.80% in 2009). The valuation projected that contribution rates would continue to rise to a staggering 44.73% of an employee's annual salary by 2015 and remain there through 2030 – the end of the then-existing amortization period.

future pension benefits," the General Assembly nonetheless found RIRSA both "reasonable and necessary to achieve and protect" the compelling public interests articulated therein. *Id.*

Based on the General Assembly's findings, RIRSA was intended to create a fiscally sound and affordable system that would be sustainable in the long term. As judged by its own words, RIRSA *did* function as intended.

The funded ratio – a major impetus for reform in the first instance – has increased by 14.4 percentage points, from 48.4% to 62.8% and has kept pace with actuarial projections from the time of reform. Though there is still much progress to be made, the pension fund continues to grow and is expected to reach 80% funded by 2030 and 82.3% funded by 2031. To the casual observer growth may seem slow, but this was expected. Contemporary forecasts showed that the fund would stay between 50% and 60% funded for about ten years before seeing larger annual increases. The UAAL has also steadily declined to a more manageable level and is expected to continue to fall so long as the state continues to make the ARC and assuming there are no additional changes to the pension system.

Actual and projected contributions have not grown dramatically – as the legislature warned they would absent reform – but have been relatively consistent over the past decade. As a measure of efficacy, projections indicate the state share of contributions would have totaled $6.3 billion over the last 11 years – $2.9 billion dollars higher than Rhode Island's actual contribution. For the upcoming fiscal year, the state contribution is projected to be $370.2 million. The state share is expected to peak in 2035 at about $450 million before sharply falling thereafter. Considered relative to the state's fiscal abilities, the current contribution rate and budgetary share allocated to fund the pension system is exceedingly more affordable and sustainable than in past years.

Objective actuarial findings thus support the conclusion that RIRSA achieved the stated goals of reform. This data indicates that RIRSA helped stabilize the pension system, ensure the availability of adequate retirement funds, and dramatically reduce state and taxpayer costs to fund the system.

At the same time, it is quite clear the General Assembly acknowledged and accepted the underlying reality that the reforms would have a negative financial impact on state employees and retirees. The legislature nonetheless considered inaction to pose too great a risk to pensioners and taxpayers alike.

Though the General Assembly understood the reform would have negative consequences, those impacts have been amplified by unexpected intervening events. Specifically, the interplay between the 2011 reform, unusually high inflation rates, and shifts in employee behavior since 2011 may have produced unexpected outcomes.

Inflation is an increase in goods overtime and a corresponding decline in purchasing power over the same period. The Consumer Price Index ("CPI") "measures inflation as experienced by consumers in their day-to-day living expenses." U.S. Department of Labor Statistics, *Consumer Price Index: Overview* (Sept. 6, 2023).

COLAs provide a measure of protection against inflation. *See* Alicia Munnell, *Social Security's 3.2% COLA Reflects Cooling Inflation*, Center for Retirement Research at Boston College (Oct.

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18, 2023). "The intent of these adjustments is to offset the losses beneficiaries suffer in the purchasing power of the dollar as the result of inflation." John F. Early, *Adverse Effects of Automatic Cost-of-Living Adjustments to Entitlement and Other Payments*, CATO Policy Analysis, No. 952, at 2 (Jun. 22, 2023). Indeed, Rhode Island's statutory COLA considers CPI as part of the calculation. *See* R.I. Gen. Laws §§ 16-16-40 (g)(1)(B); 36-10-35 (h)(1)(B); 45-21-52 (d)(1)(B).

In the years since reform, Rhode Island's pensioners have not received a material benefit adjustment.[14] This was – of course – an expected facet of the reforms. The General Assembly specifically recognized that much of ERSRI's unfunded liability – approximately 78% – "is represented by future cost of living adjustments," and thus found it "essential that the COLA benefits for retirees be impacted as part of this comprehensive reform of the retirement system." Pub. L. 2011, Ch. 408, § 1.

Though not explicitly stated, it is reasonable to assume the legislature expected inflation would have a negative impact on pensioner purchasing power until the pension fund reached the 80% threshold necessary for benefit restoration. But it is considerably less likely that the legislature would have expected the dramatic rise in inflation that has occurred over the past several years.

"Between the start of 1991 and the end of 2019, year-over-year inflation averaged about 2.3% a [year] and exceeded 5.0% only four times." Drew Desilver, *In the U.S. and around the world, inflation is higher and getting higher*, Pew Research Center (Jun. 15, 2022). But in 2022, consumer prices rose 9.1% – the largest single-year increase in 40 years. *See* United States Bureau of Labor Statistics, *Consumer prices up 9.1 percent over the year ended June 2022, largest increase in 40 years* (Jul. 18, 2022). While disinflation was substantial over 2023, the inflation rate remains over 3%. *See* The White House, *December 2023 CPI Report* (Jan. 11, 2024). This inflation spike was the result of many pandemic-induced factors. Ben Bernanke and Olivier Blanchard, *What Caused the U.S. Pandemic-Era Inflation*, Hutchins Center Working Paper #86 (June 2023); Organization for Economic Cooperation and Development, *How inflation challenges pensions* (Dec. 2022).

While inflation has impacted many across the state, it is likely to have had a particular impact on pensioners – especially lower earners – whose benefits have been largely stagnant since 2011. Those who enacted RIRSA were unlikely to have expected the actual increase in inflation, its causes, and the effect it has had on those impacted by the 2011 reforms. Though *some* fiscal impact was expected to result from inflation, the degree to which inflation has diminished the value of pensioners' annuity payments over time was not.

Throughout the course of its review, the Working Group also considered testimony – both anecdotal and empirical – that the 2011 reforms have had a negative impact on the state's ability to hire and retain employees.

From the legislative record, it is unclear whether the General Assembly considered the impact the reforms may have on the state's ability to hire and retain employees. Pension reform is certainly

[14] Pensioners have received two adjustments since 2012. In 2017, pensioners received a 0.74% COLA. In 2021, pensioners received a 1.06% COLA.

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known to have *some* impact on employee retention. *See*, *e.g.*, Dan Doonan, Testimony before the January 17, 2024 Hearing of the Pension Advisory Working Group, National Institute on Retirement Security; Laura D. Quinby and Gal Wettstein, *Do Benefit Cuts Encourage Public Employees to Leave?*, Center for Retirement Research at Boston College, State and Local Pension Plans Number 65 (May 2019). The 2011 reforms changed the design of Rhode Island's traditional DB retirement, introduced a hybrid model that includes both DB and DC components, and impacted retirement benefits.

But the impact these changes had on employee decision-making may well depend on "whether the analysis is considering more junior and mid-career personnel versus senior employees." Asch, *et al.*, *supra*, at 2; Laura D. Quinby, Testimony before the December 14, 2024 Hearing of the Pension Advisory Working Group, Center for Retirement Research at Boston College.

Consider the impact of the hybrid model. In a DB plan, benefit eligibility is based on age and years of service. This leads "to pension wealth accrual over a worker's career that is 'backloaded' toward more senior career years." *Id.* (internal citation omitted). This plan design "provides strong incentives to stay with [the state] prior to benefit eligibility – a 'pull' effect." *Id*. Rhode Island's DB plan likewise provides that once benefits commence, full-time continued employment is no longer allowed,[15] "leading to a strong incentive to leave [state service] once one is eligible to receive benefits – a 'push' effect." *Id.* The DC plan does not reward long-term service, *per se*, but does promote later retirement because it lacks a normal retirement age. The DC plan structure also facilitates employee mobility – since plans are portable – which is more attractive to some employees. *See* Pew Charitable Trust, *Retirement Needs and Preferences of Younger Public Workers* (May 16, 2017) (finding "[y]oung workers' top priority for their retirement plans is the ability to take savings with them when changing jobs").

There is also scholarly disagreement as to the impact of plan structure on employee behavior in the first instance. *See, e.g.*, Barbara Biasi, *Higher Salaries or Higher Pensions? Inferring Preferences from Teachers' Retirement Behavior*, The City University of New York, at 1-4 (Nov. 16, 2019). Indeed, some empirical data shows younger generations prefer higher wages early in their career to a higher benefit in retirement. *See* Pew Charitable Trust, *Retirement Needs and Preferences of Younger Public Workers* (May 16, 2017).

Consistent with testimony before the Working Group, the impact of reform on employee recruitment and retention is difficult to isolate and quantify given the number of push and pull factors that may influence an employee's decision to accept employment and remain in state service. *See, id.*; Beth J. Asch, *et al.*, *The Effects of Public Sector Retirement Plan Reform on Workforce Retention: Evidence from Teachers in Three States*, Pew Charitable Trusts, at 1 (Dec. 2022). Employee retention is a dynamic, multi-faceted problem that cannot be attributed to any single factor. *See* Doonan, *supra.*; Quinby, *supra*.

[15] While state law permits partial post-retirement employment, the salary and number of days an employee can work in retirement are limited by statute.

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<u>OPTIONS REQUESTED FOR CONSIDERATION</u>

Consistent with the Working Group's legislative charge, this Report analyzes various options for consideration by the General Assembly with a clear cost-benefit analysis for each option. The options assessed in this section are topically grouped. Neither the groupings nor the order in which groupings appear reflect any preference by the Office of the General Treasurer or of the Working Group.

The cost associated with each option has been determined using accepted actuarial accounting standards. In preparing the cost assessment, the state actuary assumed that the effective date for all options is July 1, 2024, unless otherwise noted. Legislation produced in response to this Report may have a different impact, depending on the precise language and effective date of any such legislation.

BASELINE COST

As a guide for the relative impact of any change, the state actuary provided a baseline, demonstrating the cost, contribution rate, unfunded liability and funded ratio for the current fiscal year absent reform. Costs detailed herein represent costs *in addition* to the baseline cost.

The projected state and local contribution to ERSRI is $544.3 million dollars for Fiscal Year 2025, which consists of $370 million from the state and $174.1 million from the municipalities. The contribution rate is 25.53% of payroll. As of the last valuation, the cumulative funded ratio of ERSRI, SPRBT, and RIJRFT is 62.8%. The unfunded actuarial accrued liability is $4.495 billion.

I. OPTIONS PERTAINING TO THE RETIREMENT BENEFIT CALCULATION

The benefit afforded to ERSRI and MERS members under Rhode Island's Defined Benefit ("DB") plan uses a formula based on three factors: the number of years of service, the final average salary of the employee, and a benefit accrual rate, also referred to as a benefit multiplier or as service credit. *See* R.I. Gen. Laws §§ 16-16-12 (a)(ii); 36-10-9 (1)(a)(ii); 45-21-16 (1)(b). The options presented in this section would amend one of these three factors, and thus directly increase an employee's benefit in retirement.

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A. *Amend the final average salary formula from the highest five years of pay to the highest three years of pay for teachers and state and municipal employees.*

State law provides that an employee's final average salary is based on the average of the five *highest* consecutive years of earnings, regardless of when they occur. *See* R.I. Gen. Laws § 36-8-1 (5); R.I. Gen. Laws § 16-16-1 (9) (incorporating the definition under Title 36); R.I. Gen. Laws § 45-21-2 (8)(a).[16]

RIRSA did not impact the final average salary formula. Amendments to the final average salary formula for teachers and state employees trace back to the 2009 reform, when the final average salary formula was increased from the average of an employee's highest three years of pay to the average of their five highest years of pay. *See* Pub. L. 2009, Ch. 68, Art. 7. This proposed option would undo that change and revert to the pre-2009 benefit.

DB pension systems use an employee's final average salary to determine the size of that employee's pension payment. The highest five-year average calculation is intended to prevent and deter a common practice referred to as "salary spiking." A salary spike is a strategic increase in late-career compensation intended to increase an employee's retirement income.

Salary spiking is problematic for two reasons. "First, salary spiking can result in unfunded liabilities," since an employee's retirement benefit will deviate from expected levels of compensation growth, generally assumed to be constant. Dan Goldhaber, *et al.*, *A Method for Identifying Salary Spiking: An Assessment of Pensionable Compensation and Reform in Illinois*, Center for Analysis of Longitudinal Data in Education Research, Working Paper No. 238-0620, at 1 (June 2020). Expected compensation, in turn, drives employer and employee contribution rates during an employee's working life. The costs of unfunded liabilities "are ultimately borne by taxpayers." *Id*. "Second, salary spiking (particularly the most egregious cases) is likely to be viewed by the public as an abuse of the system and inherently unfair." *Id*.

The five-year average set out in current statutory provisions disincentivizes salary spiking. To 'spike' an employee's retirement benefit, the law currently requires an employer to pay an inflated salary for at least five years. This option may increase the likelihood and effectiveness of a late-career salary spike by reducing the final average salary term. Consequently, salary spiking – and difficulties associated with identifying and policing the practice – increase the projected costs associated with this option.

This option would increase the total state and local contribution to the pension system by $12.2 million in Fiscal Year 2025. This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is largely attributable to the increase in the employer contribution rate, which would increase by 0.59% of payroll – from

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[16] Members of ERSRI eligible to retire as of September 30, 2009, are subject to a different definition. *See* R.I. Gen. Laws § 36-8-1 (5); R.I. Gen. Laws § 16-16-1 (9) (incorporating the definition under Title 36). For those members, final average compensation is based on the average of the three highest consecutive years of earnings, regardless of when they occur. *See, id.* Members of MERS eligible to retire on or prior to June 30, 2012, are likewise subject to a three-year average. R.I. Gen. Laws § 45-21-2 (8)(a).

26.53% to 27.12% – as result of this change. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

Further, this option would increase the unfunded liability by $102 million and decrease the funded ratio by 0.5%, from 62.8% to 62.3%. It would delay COLA restoration by approximately one year. The legislature would need to appropriate an additional $17.5 million ($7.7 million for state employees, $9.8 million for teachers) annually over a ten-year amortization period to implement this benefit enhancement without negatively impacting COLA restoration.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS	MERS GENERAL UNITS
Normal Cost	0.20%	0.17%	0.19%
UAAL	$45 million	$57 million	$12 million
Funded Ratio	-0.6%	-0.5%	-0.8%
Projected FY25 Contribution			
Percent of Payroll	0.63%	0.57%	0.52%
Est. Annual Dollar Amount	$5.3 million	$6.9 million	$1.6 million

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B. *Increase the rate of benefit accrual (the "accrual rate" or "multiplier") for active members of ERSRI.*[17]

In Rhode Island's DB plan, an employee's benefit is expressed as a percentage of the employee's final average salary. *See* R.I. Gen. Laws §§ 16-16-12 (a)(ii); 36-10-9 (1)(a)(ii). "The percentage is usually a function of the employee's years of service times a 'multiplier' percentage." Reason Foundation, Public Pension Glossary (July 1, 2021). A higher rate of benefit accrual (that is to say, a higher 'multiplier') generally corresponds to a higher pension benefit. Over the course of three hearings, the Working Group was presented with several proposals which would increase the accrual rate for active employees.

RIRSA was not the first reform to impact the accrual rate. As such, a historical overview of statutory changes is necessary to fully contextualize the changes to the state's accrual laws that occurred in 2011. In 2005, the General Assembly passed a series of partial pension reforms as part of the state budget. *See* Pub. L. 2005, Ch. 117, Art. 7. This reform created two schedules for state employees and teachers – one consisting of members with at least ten years of service (and were therefore 'vested') by July 1, 2005 ("Schedule A"), and one consisting of members with less than ten years of service as of that date ("Schedule B"). *See id.; infra*.

The legislature introduced another round of reforms in 2009, impacting accrual rates for members who were not eligible to retire by September 30, 2009, and newly hired employees in the state system. *See* Pub. L. 2009, Ch. 68, Art. 7. Schedule A members who were not grandfathered (*i.e.*, members who had at least 10 years of creditable service as of June 30, 2005 but were not eligible to retire as of September 30, 2009) benefits are based on Schedule A for service through September 30, 2009 and Schedule B for service after September 30, 2009. *See* Employees' Retirement System of Rhode Island, Actual Valuation Report as of June 30, 2023, Appendix 2, at 47. The accrual rates associated with each schedule are illustrated in the table below:

Benefits Prior to 2005 Pension Reform	Benefits Resulting From 2005 Pension Reform
Schedule A (Employees vested prior to 07/01/2005)	**Schedule B** (Employees vested after 07/01/2005)
Years 1 to 10 - 1.7%	Years 1 to 10 - 1.6%
Years 11 to 20 - 1.9%	Years 11 to 20 - 1.8%
Years 21 to 34 - 3.0%	Years 21 to 25 - 2.0%
Year 35 - 2.0%[18]	Years 26 to 30 - 2.25%
	Years 31 to 37 - 2.5%
	Year 38 - 2.25%[19]

[17] During the January 31, 2024 hearing, the state actuary presented a number of funding alternatives concerning various accrual rate options that would reduce the budgetary impact. A full explanation and actuarial assessment of those funding alternatives is available in Appendix Document 10, at pages 49, 52, 53 and 54.

[18] Schedule A accrual was statutorily capped at 80% of compensation payable at completion of 35 years of service. *See* Pub. L. 2005, Ch. 117, Art. 7.

[19] Following the 2005 reform, Schedule B accrual was statutorily capped at 75% of compensation payable at completion of 38 years of service. *See* Pub. L. 2005, Ch. 117, Art. 7.

Under current law, members of ERSRI and MERS general units accrue 1% per year of service.[20] *See* R. I. Gen. Laws §§ 16-16-13 (c); 36-10-10 (d); 45-21-17 (a). Members of the State Police Retirement Benefits Trust ("SPRBT") and correctional officers accrue 2% per year of service. *See* R.I. Gen. Laws § 42-28-22 (j) (state police officers); R. I. Gen. Laws § 36-10-20.2 (corrections officers). Members of the Rhode Island Judicial Retirement Fund Trust ("RIJRFT") receive either 80% or 65% of their highest five consecutive years of compensation, depending on length of service. *See* R.I. Gen. Laws § 8-3-8 (a).

The Working Group was presented with three options concerning the accrual rate:

(1) **Increase the accrual rate from 1% to 1.5% for members of ERSRI and MERS general units**.

This option would increase the total state and local contribution to the pension system by $45.7 million in Fiscal Year 2025. This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is attributable to the increase in the employer contribution rate, which would increase by 2.23% of payroll, from 26.53% to 28.76%. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

The unfunded liability would increase by $289 million and decrease the funded ratio by 1.5%, from 62.8% to 61.3% and delay COLA restoration at least a year. The legislature would need to appropriate an additional $60.8 million ($20.2 million for state employees, $40.6 million for teachers) annually over a ten-year amortization period to implement this benefit enhancement without impacting the funded ratio.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS	MERS GENERAL UNITS
Normal Cost	2.66%	2.50%	2.85%
UAAL	$88 million	$201 million	$33 million
Funded Ratio	-1.1%	-1.8%	-2.1%
Projected FY25 Contribution			
Percent of Payroll	1.84%	2.50%	2.14%
Est. Annual Dollar Amount	$15.6 million	$30.2 million	$6.4 million

[20] As a part of the 2015 settlement agreement, the future accrual rate (post July 1, 2015) was increased to 2% per year of service, subject to a corresponding increase in the member contribution rate for state employees, teachers, and active municipal employees in the MERS system with 20 years of service as of June 30, 2012. *See Clifford v. Raimondo*, 184 A.3d 673, 681 (R.I. 2018); R. I. Gen. Laws §§ 16-16-13 (c); 36-10-10 (d); 45-21-17 (a).

(2) **Create a three-tiered accrual rate as follows**:

1 to 10 years of service	-	1.25% accrual
11 to 20 years of service	-	1.5% accrual
21 years of service to retirement	-	2% accrual

Because this option progressively increases service accrual for late career employees, it incentivizes employees to stay in the system longer. This could increase mid-career employee retention, but it may mean employees stay well past retirement eligibility to take advantage of the larger multiplier, thereby increasing their retirement benefit. This is reflected in the cost associated with this option.

This option would increase the total state and local contribution to the pension system by $76.9 million in Fiscal Year 2025. This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is attributable to the increase in the employer contribution rate, which would increase by 3.75% of payroll, from 26.53% to 30.28%. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

The unfunded liability would increase by $531 million and decrease the funded ratio by 2.6%, from 62.8% to 60.2% and delay COLA restoration at least a year. The legislature would need to appropriate an additional $104.6 million ($32.2 million for state employees, $72.3 million for teachers) annually over a ten-year amortization period to implement this benefit enhancement without impacting COLA restoration.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS	MERS GENERAL UNITS
Normal Cost	2.47%	2.78%	2.53%
UAAL	$152 million	$379 million	$52 million
Funded Ratio	-1.8%	-3.3%	-3.2%
Projected FY25 Contribution			
Percent of Payroll	2.86%	4.37%	3.02%
Est. Annual Dollar Amount	$24.2 million	$52.6 million	$9.1 million

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

(3) **Create a four-tiered accrual rate as follows**:

1 to 10 years of service	-	1.25% accrual
11 to 20 years of service	-	1.5% accrual
21 to 30 years of service	-	2% accrual
31 to 35 years of service	-	2.5% accrual

Because this option progressively increases service accrual for late career employees (particularly for those with over 30 years of service), it incentivizes employees to stay in the system longer. This could increase mid-career employee retention, but it may mean employees stay well past retirement eligibility to take advantage of the larger multiplier, thereby increasing their retirement benefit. This is reflected in the cost associated with this option.

Were this option to be implemented as proposed, it would create particular inequity in the system. Members with more than 20 years of service by July 1, 2012 (the effective date of RIRSA) contribute 11% to the DB plan (those with less than 20 years contribute 5% to the DC plan and 3.75% to the DB plan for a total contribution of 8.75%). Consequently, members in that schedule would be contributing 2.25% more of their annual salary, for a fairly similar benefit than those with less service (*see* "Schedule B," *supra*.).

This option would increase the total state and local contribution to the pension system by $89.3 million in Fiscal Year 2025. This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is attributable to the increase in the employer contribution rate, which would increase by 4.35% of payroll, from 26.53% to 30.88%. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

The unfunded liability would increase by $637 million and decrease the funded ratio by 3.1%, from 62.8% to 59.7% and delay COLA restoration at least a year. The legislature would need to appropriate an additional $122.5 million ($36.5 million for state employees, $86 million for teachers) annually over a ten-year amortization period to implement this benefit enhancement without impacting COLA restoration.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS	MERS GENERAL UNITS
Normal Cost	2.48%	2.94%	2.54%
UAAL	$177 million	$460 million	$58 million
Funded Ratio	-2.1%	-3.9%	-3.6%
Projected FY25 Contribution			
Percent of Payroll	3.21%	5.15%	3.27%
Est. Annual Dollar Amount	$27.2 million	$62.1 million	$9.8 million

II. RETIREMENT AGE AND EARLY RETIREMENT PENALTIES

A. *Decrease the retirement age from the 'Rule of 95' – wherein an employee's combined age and years of service must equal at least 95 to be eligible to retire – to the 'Rule of 90,' a five-year reduction.*

Retirement age and benefits for teachers, state employees, and municipal employees are set by statute and calculated by formula. Under prevailing law, teachers, state employees, and municipal employees are eligible to retire:

(1) If they have reached Social Security retirement age and completed at least five years of contributory service since July 1, 2012; or
(2) If they have reached social security retirement age and completed five or more years of contributory service before July 1, 2012, a proportional formula is used to calculate retirement, but in any event must be no less than age 59.

See R. I. Gen. Laws §§ 16-16-12 (c)-(d), 36-10-9 (c)-(d); 45-21-16 (B)-(C). The 'Rule of 95' is an "alternative full benefit retirement eligibility date," which allows members to retire earlier than their schedule-based eligibility date.[21] *See* Robert Hiltonsmith, *Rhode Island's New Hybrid Pension Plan Will Cost the State More While Reducing Retiree Benefits*, Economic Policy Institute Issue Brief #366 (June 20, 2013), at 3.; *see also* R. I. Gen. Laws §§ 16-16-12 (c)-(d), 36-10-9 (c)-(d); 45-21-16 (B)-(C).[22] "Under the Rule of 95, members can retire when their age plus their years of service equal 95 provided that they are at least 62 years old." Hiltonsmith, *supra*, at 3. As such, an individual is eligible to retire where:

(1) They have reached at least 65 years of age with 30 years of service; or
(2) They have reached at least 64 years of age with 31 years of service; or
(3) They have reached at least 63 years of age with 32 years of service; or
(4) They have reached at least 62 years of age with 33 years of service.

See R. I. Gen. Laws §§ 16-16-12 (d)(A); 36-10-9 (d); 45-21-16 (C).

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[21] ERSRI, *Retirement Eligibility Rules, Eligibility based on the Rule of 95*, accessed Jan. 12, 2024, at Retirement Eligibility | ERSRI.

Prior to RIRSA, teachers and state employees could retire with full benefits at age 65 with 10 years of service, or at age 62 with 29 years of service. *See* Gabriel Roeder Smith & Company, Rhode Island Retirement Security Act of 2011: Plan Details, at *2 (October 2011).

Colloquially known as the "Rule of 90," this option would allow teachers, state employees, and municipal employees to retire if they are at least 60 years of age and their combined age and years of service equals at least 90. Therefore, an individual would be eligible to retire where:

(1) They have reached at least 63 years of age with 27 years of service; or
(2) They have reached at least 62 years of age with 28 years of service; or
(3) They have reached at least 61 years of age with 29 years of service; or
(4) They have reached at least 60 years of age with 30 years of service.

This option is unlikely to have a short-term impact on retirement dates, since teachers, state employees, and municipal employees with nearly three decades of service are likely to be in retirement schedules that were unimpacted by this facet of RIRSA. Therefore, such members would *already* be eligible to retire so this change would not impact retirement decisions.

While it is uncertain, this option may have benefit implications. Projected replacement income from the current DB and DC plans is based on a career employee that retires under prevailing retirement provisions. This option would, of course, permit teachers, state employees, and municipal employees to retire five years earlier than they are currently permitted. If an employee retires earlier – as one would anticipate – that employee will not receive up to five years' worth of employer and employee contributions that they *would have* received under the existing system. This will decrease an individual's retirement income, potentially impacting financial security in retirement unless it is accompanied by a benefit increase in retirement or during the employee's working life.

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

This option would increase the total state and local contribution to the pension system by $12.1 million in Fiscal Year 2025. This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is largely attributable to the increase in the employer contribution rate, which would increase by 0.59% of payroll – from 26.53% to 27.12% – as result of this change. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

Further, the unfunded liability would increase by $106 million and decrease the funded ratio by 0.5%, from 62.8% to 62.3% and delay COLA restoration by approximately one year. The legislature would need to appropriate an additional $17.7 million ($3.6 million for state employees, $14.1 million for teachers) annually over a ten-year amortization period to implement this benefit enhancement without negatively impacting COLA restoration.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS	MERS GENERAL UNITS
Normal Cost	0.09%	0.21%	0.06%
UAAL	$21 million	$85 million	$4 million
Funded Ratio	-0.3%	-0.8%	-0.3%
Projected FY25 Contribution			
Percent of Payroll	0.29%	0.80%	0.18%
Est. Annual Dollar Amount	$2.5 million	$9.7 million	$0.5 million

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B. *Cap early retirement penalties at 3% per year.*

Teachers, state employees, and municipal employees who seek to retire early incur a statutory penalty. *See* R.I. Gen. Laws § 16-16-12 (c)(iii); R.I. Gen. Laws § 36-10-9 (c)(iii); R.I. Gen. Laws § 45-21-16 (1)(ii)(C). If a member has completed at least 20 years of service and is within five years of retirement eligibility, that member may retire but their retirement benefit is reduced in accordance with the following table:

Year Preceding Retirement	Percent Reduction	Cumulative Reduction
For Year 1	9%	9%
For Year 2	8%	17%
For Year 3	7%	24%
For Year 4	7%	31%
For Year 5	7%	38 %

See ERSRI, *Retirement Eligibility*, accessed Jan. 15, 2024, at https://www.ersri.org/members/retirement-eligibility; R.I. Gen. Laws § 16-16-12 (c)(iii); R.I. Gen. Laws § 36-10-9 (c)(iii); R.I. Gen. Laws § 45-21-16 (1)(ii)(C).

This legislative proposal would limit the early retirement reduction, capping the reduction at 3% annually if an employee retires within five years of their statutorily prescribed retirement date.

Generally, early retirement usage is low and is currently assumed to be 1% of members. For purposes of this assessment, the state actuary assumed this would increase to 3% of members. Despite the comparatively small population expected to take advantage of this provision, it will still have a negative cost impact. This cost is twofold:

(1) Members are more likely to retire earlier than they otherwise may have; and
(2) Members that utilize early retirement will receive a larger benefit because the early retirement discount is lower.

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Thus, this option would increase the total state and local contribution to the pension system by $8.5 million in Fiscal Year 2025. This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is largely attributable to the increase in the employer contribution rate, which would increase by 0.41% of payroll – from 26.53% to 26.94% – as result of this change. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

Further, the unfunded liability would increase by $70 million and decrease the funded ratio by 0.4%, from 62.8% to 62.4%, and delay COLA restoration by approximately one year. The legislature would need to appropriate an additional $12.2 million ($3.3 million for state employees, $8.9 million for teachers) annually over a ten-year amortization period to implement this benefit enhancement without negatively impacting COLA restoration.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS	MERS GENERAL UNITS
Normal Cost	0.10%	0.15%	0.18%
UAAL	$18 million	$52 million	$7 million
Funded Ratio	-0.20%	-0.50%	-0.5%
Projected FY25 Contribution			
Percent of Payroll	0.27%	0.51%	0.37%
Est. Annual Dollar Amount	$2.3 million	$6.2 million	$1.1 million

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

III. OTHER ACTIVE EMPLOYEE BENEFIT ENHANCEMENTS

A. *Increase the state's contribution to the Defined Contribution 401(a) plan by 1%.*

Employers contribute 1% to the DC plan by statute (3% for teachers or MERS non-police or fire employees not covered by Social Security). *See* RI 401(a) Adoption Agreement, executed Jun. 29, 2012. This option would increase the State's contribution to the DC plan by a set percent, thereby increasing a member's retirement benefit.

The Working Group has considered testimony that Rhode Island's contribution to the DC plan is relatively uncompetitive, particularly compared to other states and to the private market. Data provided by Pew Charitable Trusts indicates that the average state contribution to public DC plans is 1.9%, approximately 1% higher than that in Rhode Island. The average employee contribution is 3.1%, below the 5% required employee contribution rate in Rhode Island.[23]

Several states with a DC component also allow for higher voluntary contributions, or in some instances voluntary reductions. The default employee contribution in Georgia, for example, is 5%, but the state permits an employee match up to 9%. *See* Aleena Oberthur and Mollie Mills, *Retirements at Risk: Many States Fall Short in Helping Mid-Career Workers Save*, Pew Charitable Trust (Jul. 31, 2023). Similarly, the default employer and employee contribution in Virginia is 1%, but employees who contribute 4% receive an additional 2.5% employer match.

A one percent increase to the employer contribution in the DC plan would increase the total state and local contribution to the pension system by approximately $19.1 million in Fiscal Year 2025. This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This figure provides decision-makers a rough guide as to the cost of each percent increase to the DC plan. Because this option impacts the DC plan, this change would not delay COLA restoration, or impact the funded ratio of the DB plan.

This change would help bolster retirement income for career employees and would make the state more competitive relative to other states and the private sector. However, it is unclear whether a one percent increase in the employer contribution would have a material impact on an employee's decision to seek state employment or remain in a state job.

[23] The data in this paragraph was provided by David Draine, a Principal Officer in Public Sector Retirement Systems with Pew Charitable Trusts.

B. *Mandate all new municipal employees – specifically teachers and public safety personnel – be included in Social Security.*

Under Rhode Island law, state employees are provided coverage under the federal Social Security Act (codified under 42 U.S.C. § 301 *et seq*.). Municipalities and regional school districts *may* elect to provide their employees Social Security through a resolution or ordinance by the local governing authority but are not required to do so. Teachers who are not covered by Social Security are subject to a higher contribution rate[24] but their beneficiaries are eligible to receive benefits provided under the Teachers' Survivors Benefits Fund (the "TSB" Fund). *See* R.I. Gen. Laws § 16-16-25.

Currently, the following municipalities do not offer all or some employees a Social Security option:

MERS UNIT	PLAN
Barrington	Teachers
Bristol	Teachers and Police
Burrillville	Teachers, Harrisville Fire, Pascoag Fire
Central Falls	Teachers, Police, Fire
Coventry	Teachers, Fire
Cranston	Teachers, Police, Fire
Cumberland	Teachers, Fire
East Greenwich	Teachers, Fire
East Providence	Teachers
Foster Glocester	Teachers
Glocester	Teachers
Hopkinton	Hope Vally, Wyoming Fire, Hopkinton Police
Johnston	Teachers
Lincoln	Teachers, Lime Rock Fire
Little Compton	Teachers
Middletown	Teachers
Newport	Teachers, Police
North Smithfield	Teachers, Union Fire
Portsmouth	Teachers
Scituate	Teachers
Smithfield	Teachers
Tiverton	Teachers
Warren	Teachers
Westerly	Teachers
West Greenwich	Hopkins Hill Fire
Woonsocket	Police, Fire

This option would require municipalities to offer all new employees Social Security. The Social Security tax rate for employers and employees is 7.65% of employee payroll (6.2% for Social

[24] Teachers who are not covered by Social Security must contribute 7% of their compensation to increase their replacement income in retirement, whereas all other teachers must contribute 5%. *See* ERSRI Audit Fiscal Year Ended June 30, 2022, at 27; RI 401(a) Adoption Agreement, executed Jun. 29, 2012.

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Security, 1.45% for Medicare). *See* Internal Revenue Service, *Topic No. 751, Social Security and Medicare withholding rates*, accessed Jan. 16, 2024, at https://www.irs.gov/taxtopics/tc751. While this change would not impact the state budget it will impact municipal budgets. The impact on a particular municipality will depend on the number of excluded employees.

To extend Social Security coverage to a new group of employees, the state must amend a document colloquially referred to as the Section 218 Agreement. A Section 218 Agreement "is a voluntary agreement between the State and the Social Security Administration (SSA) to provide Social Security . . . coverage for State and local government employees." Social Security Administration, *What is a Section 218 Agreement?*, accessed February 14, 2024, at https://www.ssa.gov/slge/sect_218_agree.htm?tl=0.; *see* 42 U.S.C. § 418. An amendment to the Section 218 Agreement to include municipal employees currently requires a municipal ordinance or resolution.

The Working Group did not consider testimony concerning the state's legal authority to require universal municipal participation in the Section 218 Agreement.

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

IV. OPTIONS PERTAINING TO PUBLIC SAFETY PROFESSIONALS

Given the unique retirement provisions and considerations affecting public safety personnel, the Working Group addresses options pertaining to MERS Police and Fire units separately. Costs presented in this section are borne *pro rata* by municipalities with public safety units in the MERS system but are expressed collectively for simplicity.

Costs are likewise presented relative to a baseline: where the MERS system would be absent any change. Any cost or impact is *in addition* to the current baseline.

Without change, the MERS contribution rate across MERS police and fire units is 17.33% of payroll and costs municipalities a collective $25.6 million annually. The cumulative unfunded liability is currently $129 million. The cumulative funded ratio is 86.5%. However, the funded status of each MERS unit is considered *independently*. For instance, a MERS unit will receive a COLA when that particular unit reaches 80% funded. R.I. Gen. Laws § 45-21-52 (c)(3). Because MERS units are assessed independently, some of the options presented herein may impact a unit's COLA eligibility if the anticipated impact results in a funded ratio below 80%. Therefore, a unit currently receiving a COLA may no longer receive a COLA for a period of time until the funded ratio returns to 80%.

OVERVIEW OF MERS POLICE AND FIRE BENEFITS UNDER THE CURRENT SYSTEM AND BEFORE 2011 REFORM

An overview of the pertinent retirement provisions pertaining to public safety professionals – and the state of the law before RIRSA – is necessary to provide complete context concerning the options presented in this section. Under current state law, members of MERS police and fire units are eligible to retire:

(1) At age 55 provided they have completed at least 25 years of service;
(2) At any age provided they have completed at least 27 years of service; or
(3) At Social Security retirement age provided they have completed at least five years of service.

See R.I. Gen. Laws § 45-21.2-5(b). By ordinance, local legislative bodies may permit retirement of a member on a service retirement allowance at any age provided they have completed at least 20 years of service.

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Members who seek to retire early incur a statutory penalty. *See id.* If a member has completed at least 20 years of service and is within five years of retirement eligibility, that member may retire but their retirement benefit is reduced in accordance with the following table:

Year Preceding Retirement	Percent Reduction	Cumulative Reduction
For Year 1	9%	9%
For Year 2	8%	17%
For Year 3	7%	24%
For Year 4	7%	31%
For Year 5	7%	38 %

See ERSRI, *Retirement Eligibility*, accessed Jan. 15, 2024, at https://www.ersri.org/members/retirement-eligibility; R.I. Gen. Laws § 45-21.2-5(b)(5).

As under ERSRI, the benefit afforded to MERS public safety professionals under the DB plan uses a formula based on three factors: the number of years of service, the final average salary of the employee, and a benefit accrual rate (*i.e.*, the 'multiplier'). *See* R.I. Gen. Laws § 45-21-16 (1)(b). The final average salary for members of MERS police and fire units is based on:

(1) "[T]he period of three (3) consecutive years within the total service of the member when [average annual compensation, pay or salary] was highest" for members who retired on or prior to June 30, 2012; or
(2) "[T]he average annual compensation of a member for services rendered during the period of the highest five (5) consecutive years within the total service of the member" for all members retiring on or after July 1, 2012.

See R.I. Gen. Laws § 45-21-2 (8).

Concerning the benefit multiplier, members of MERS police and fire units generally accrue 2% per year of service. *See* R.I. Gen. Laws § 45-21.2-6 (subject to increased accrual rates for long term service); ERSRI, *Annual Service Credit Accruals by Employment Type and Schedule*, accessed Jan. 16, 2024 at https://www.ersri.org/members/retirement-planning/accruals-by-schedule. Members with greater than 30 years of service who are at least 57 accrue 2.25% per year, which incentivizes qualifying personnel to serve at least 30 years. *See* R.I. Gen. Laws § 45-21.2-6.

Prior to the 2011 reforms, members of MERS police and fire units were eligible to retire:

(1) At age 55 provided they have completed at least 10 years of service;
(2) At any age provided they have completed at least 25 years of service; or
(3) At age 50 provided they gave completed at least 20 years of service.

See Pub. L. 2011, Ch. 408, § 12. The retirement benefit of any member retiring early (before age 55 with less than 25 years of service) was likewise subject to a statutory penalty and reduced by one-half of one percent each month until the member reached age 55. *See id.* Once the member

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turned 55, the member was eligible to receive their full benefit. *See id.* Final average salary for MERS police and fire units was formerly based on the highest three consecutive years of pay. *See id.*

A. *Amend the final average salary formula from the highest five years of pay to the highest year of pay for municipal police and fire units.*

This proposed change would amend the final average salary formula from the highest three or five years of pay (depending on a member's retirement date) to the highest year for all members of MERS police and fire units. DB pension systems use an employee's final average salary to determine the size of that employee's pension payment. The highest five-year average calculation is intended to prevent and deter a common practice referred to as "salary spiking." A salary spike is a strategic increase in late-career compensation intended to increase an employee's retirement income.

Salary spiking is problematic for two reasons. "First, salary spiking can result in unfunded liabilities," since an employee's retirement benefit will deviate from expected levels of compensation growth, generally assumed to be constant. Goldhaber, *et al.*, *A Method for Identifying Salary Spiking: An Assessment of Pensionable Compensation and Reform in Illinois*, *supra*, at 1. Expected compensation, in turn, drives employer and employee contribution rates during an employee's working life. The costs of unfunded liabilities "are ultimately borne by taxpayers." *Id*. "Second, salary spiking (particularly the most egregious cases) is likely to be viewed by the public as an abuse of the system and inherently unfair." *Id.*

The five-year average set out in current statutory provisions disincentivizes salary spiking. To 'spike' an employee's retirement benefit, the law currently requires an employer to pay an inflated salary for at least five years.

Salary spiking – and difficulties associated with identifying and policing the practice – increase the projected costs associated with this option. Consequently, this option would increase the contribution rate by 3.22% across MERS units, and cost municipalities an additional $4.8 million annually. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. Further, the unfunded liability for all MERS plans would increase by $38 million and the cumulative funded ratio for all MERS plans would decrease by 3.2%, from 86.5% to 83.3%.

The following table describes costs attributable to this option in greater detail:

	MERS POLICE AND FIRE UNITS
Normal Cost	1.17%
UAAL	$38 million
Funded Ratio	-3.2%
Projected FY25 Contribution	
Percent of Payroll	3.22%
Est. Annual Dollar Amount	$4.8 million

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B. *Increase the rate of benefit accrual (the "accrual rate" or "multiplier") for active members of MERS police and fire units from 2% to 2.5%.*

This option would increase the accrual rate to 2.5% for each year of service for public safety personnel. As part of the retirement benefit calculation, the benefit multiplier directly impacts a member's annuity in retirement. This option is prospective, meaning it would not benefit previously retired public safety professionals.

Amending the accrual rate would increase the contribution rate by 2.22% and cost municipalities an additional $3.3 million annually. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. Further, the unfunded liability for all MERS plans would increase by $15 million and the cumulative funded ratio for all MERS plans would decrease by 1.3% from 86.5% to 85.2%.

The following table describes costs attributable to this option in greater detail:

	MERS POLICE AND FIRE UNITS
Normal Cost	2.38%
UAAL	$15 million
Funded Ratio	-1.3%
Projected FY25 Contribution	
Percent of Payroll	2.22%
Est. Annual Dollar Amount	$3.3 million

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

C. *Cap early retirement penalties for MERS police and fire units.*

Several municipalities that do not participate in MERS and manage municipal police and fire pensions independently either do not impose an early retirement penalty or impose a lesser penalty. The Working Group considered testimony opining that this disparity has made it difficult for municipalities in MERS to retain employees lured by more attractive retirement provisions in neighboring jurisdictions. This option would cap early retirement restrictions for MERS public safety professionals at 3% per year for employees within five years of retirement, in accordance with the following table:

Year Preceding Retirement	Percent Reduction	Cumulative Reduction
For Year 1	3%	3%
For Year 2	3%	6%
For Year 3	3%	9%
For Year 4	3%	12%
For Year 5	3%	15%

This option would increase the employer contribution rate by 0.01%. The cost increase is comparatively small, so the impact on municipalities attributable to this change alone is *de minimis*. This option was proposed alongside an option, discussed *infra*, which would permit members of MERS police and fire units to retire at age 57 or over with at least 20 years of service.

The following table describes costs attributable to this option in greater detail:

	MERS POLICE AND FIRE UNITS
Normal Cost	0.00%
UAAL	$0 million
Funded Ratio	0.0%
Projected FY25 Contribution	
Percent of Payroll	0.01%
Est. Annual Dollar Amount	$0.0 million

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

D. *Amend the retirement eligibility date for MERS police and fire units.*

The Working Group considered several proposals, each of which would permit firefighters and police officers in MERS general units to retire earlier than they are eligible to under current statutory provisions.

(1) **Permit members of MERS police and fire units to retire at any age provided they have completed at least 20 years of service.**

Throughout the Working Group's review, it considered anecdotal evidence of public safety burnout given the stresses and emotional impact that often accompanies their job obligations. This option would respond to that testimony and expand retirement eligibility to any firefighter or police officer with over 20 years of service. Given the nature of this change, it would render moot retirement eligibility under the current 55 years of age, 25 years of service provision.

This option would increase the employer contribution by 1.83% of payroll, resulting in an annual $2.7 million total increase from participating municipalities. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. The unfunded liability across MERS units would increase by $17 million, which would decrease the funded ratio by 1.5% from 86.5% to 85%.

The following table describes costs attributable to this option in greater detail:

	MERS POLICE AND FIRE UNITS
Normal Cost	0.91%
UAAL	$17 million
Funded Ratio	-1.5%
Projected FY25 Contribution	
Percent of Payroll	1.83%
Est. Annual Dollar Amount	$2.7 million

(2) **Reduce the retirement age for certain members of MERS police and fire units with at least 20 years of service.**

This option would permit members of MERS police and fire units to retire at age 57 or over with at least 20 years of service. Given current retirement provisions, this would impact a comparatively limited group of public safety professionals. Effectively, it would impact firefighters and police officers older than 57 but younger than 66 with over 20 years of service but less than 25 years of service that intend to retire before their twenty-fifth year of service.

The impact associated with this option is thus limited, but not *de minimis*: the employer contribution rate would increase by 0.42% of payroll, resulting in an annual $600,000 increase among participating municipalities. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. The collective unfunded actuarial accrued liability across MERS plans would increase by $5 million, and the cumulative funded ratio would decrease by 0.4% from 86.5% to 86.1%.

While cost is addressed separately, this option was presented alongside a provision which would decrease early retirement penalties for all remaining public safety professionals, as addressed *supra*.

The following table describes costs attributable to this option in greater detail:

	MERS POLICE AND FIRE UNITS
Normal Cost	0.17%
UAAL	$5 million
Funded Ratio	-0.4%
Projected FY25 Contribution	
Percent of Payroll	0.42%
Est. Annual Dollar Amount	$0.6 million

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

(3) **Reduce the retirement age for certain members of MERS police and fire units over 62 years of age, but below Social Security retirement age.**

This option would permit members of MERS police and fire units to retire at age 62 or over provided they have at least five years of service. Given current retirement provisions, this would impact a comparatively limited group of public safety professionals. Effectively, it would impact firefighters and police officers with at five years of service (but less than 25 years of service) that want to retire between 62 and 66 years of age.

The impact associated with this option is thus limited, but not *de minimis*: the employer contribution rate would increase by 0.41% of payroll, resulting in an annual $600,000 increase among participating municipalities. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. The collective unfunded actuarial accrued liability across MERS plans would increase by $2 million, and the cumulative funded ratio would decrease by 0.2% from 86.5% to 86.3%.

The following table describes costs attributable to this option in greater detail:

	MERS POLICE AND FIRE UNITS
Normal Cost	0.29%
UAAL	$2 million
Funded Ratio	-0.2%
Projected FY25 Contribution	
Percent of Payroll	0.41%
Est. Annual Dollar Amount	$0.6 million

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

E. *Provide public safety employees in ERSRI the same retirement benefits as public safety employees in MERS.*

Though the overwhelming majority of Rhode Island's public safety professionals are in MERS police and fire plans or locally administered police and fire plans, there is a small group of public safety professionals in ERSRI. Because these professionals are in ERSRI – rather than a public safety plan – they receive the same benefits as those in the state system, including the same retirement age and benefit accrual. According to testimony, this includes approximately 380 law enforcement officers (such as sheriffs, capitol police officers, and environmental police officers), firefighters and crash rescue at Quonset Airport, and juvenile program workers.

This option would help create benefit parity between this class of individuals and MERS police and fire units, given the physical and mental stresses often associated with both types of jobs. Primarily, this would impact service accrual, retirement age, and annual benefit.

Because impacted employees would remain in ERSRI (albeit with benefits comparable to those afforded MERS police and fire units), the cost would be wholly borne by the state. This option would increase the total state contribution to the pension system by $3.8 million in Fiscal Year 2025. This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is largely attributable to the increase in the employer contribution rate, which would increase by 0.45% of payroll – from 26.53% to 26.98% – as a result of this change.

Further, the unfunded liability would increase by $17 million and decrease the funded ratio by 0.2%, from 62.8% to 62.6%.

The following table describes costs attributable to this option in greater detail:

	STATE EMPLOYEES
Normal Cost	0.29%
UAAL	$17 million
Funded Ratio	-0.2%
Projected FY25 Contribution	
Percent of Payroll	0.45%
Est. Annual Dollar Amount	$3.8 million

F. *Repeal post-retirement employment restrictions for police and fire personnel relating to the number of days a retiree can work without incurring penalties.*

Retired police and fire personnel are permitted to work 75 days per year while still receiving their pension. R.I. Gen. Laws § 45-21-54. "Pension payments, however, are suspended when that period is exceeded." *See id.*

This proposed change would rescind post-retirement employment limitations, permitting a retiree to continue working full-time while collecting pension benefits. Post-retirement employment provisions can, however, be costly to a pension system. That cost is twofold:

(1) Members are more likely to retire earlier than they otherwise may have, intending to return to full employment and receive both a salary and retirement benefits; and
(2) MERS units are likely to lose revenue, since contributions will decrease if recent retirees are rehired in the place of full-time employees whose payroll would have otherwise been eligible for retirement contributions.

The 75-day post-retirement employment cap predates the 2011 reforms and was not impacted by RIRSA. *See* R.I. Gen. Laws § 45-21-54 (last amending the post-retirement employment cap in 1980).

During the course of its review, the Working Group considered anecdotal evidence from public safety professionals identifying difficulties filling positions. As proposed, this option is intended to help police and fire departments fill vacant positions – particularly auxiliary positions like dispatchers – with retired members. It is unclear whether this option will have the desired effect long term.[25]

This option would increase the contribution rate by 5.99% of payroll, increasing the total employer contribution across participating MERS units by $4.6 million annually. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. The unfunded liability across MERS units would increase by $50 million, and the funded ratio across MERS units would decrease by 4.2%, from 86.5% to 82.3%.

This cost assessment assumes that the system will not receive the employer and employee contribution. If any legislation repealing the 75-day post-employment retirement cap requires the employer to contribute as if the retiree filling the vacancy were a new hire, then the cost associated with this option would decrease. This would likewise disincentivize employers from seeking out retired members as a cost saver (since the municipality would not be required to make the employer contribution) in lieu of a new employee (in which case employer contributions are required). While the plan would still 'lose out' on the employee contribution, this change would mitigate some of the impact. Legally, it is unclear whether state law could require previously retired employees to continue to make the employee contribution to the system.

[25] Alternatively, the General Assembly may consider increasing the number of days police and fire personnel are permitted to work without revoking post-retirement employment restrictions in their entirety.

G. *Create a deferred retirement option plan ("DROP").*

While this option was not presented by public safety representatives, DROP plans are often used in public safety plans elsewhere in the country and therefore discussed in this section. However, DROP plans are not solely applicable to public safety and can be implemented with reference to a larger class of employees. *See, e.g.*, La. Rev. Stat. § 11:1152 (applying to school employees).

In recent years, "[n]umerous governments have added [DROP] features to defined benefit plans." Government Finance Officers Association ("GFAO"), *Deferred Retirement Option Plans*, accessed Jan. 15, 2024, at https://www.gfoa.org/materials/deferred-retirement-option-plans. A DROP plan would allow an employee to defer benefit collection and work past their statutory retirement age. "During DROP participation, employees do not accrue additional service or increased compensation in the defined benefit formula." *Id.* Thus, the employer would not fund the normal cost of any employee benefit as is the case for active employees.

During DROP participation, the employee's pension remains in the retirement system and continues to be invested. When the employee ultimately retires, "they typically receive the balance in the account, including interest credits, in a lump sum in addition to the monthly pension benefit accrued at the start of DROP participation." *Id.*; *see also* Samson Alva, Norma B. Coe, and Anthony Webb, *The Impact of a DROP Program on the Age of Retirement and Employer Pension Costs*, Center for Retirement Research at Boston College (Sept. 29, 2010). In effect, a DROP plan permits an employee to continue working "while at the same time . . . receiving their pension benefits in a deferred account." GFAO, *Deferred Retirement Option Plans*, *infra.* Several other jurisdictions – including, for example, Louisiana, Arizona, and Michigan – offer a DROP plan to certain retirees. *See, e.g.*, La. Rev. Stat. § 11:606 (applying to state public safety personnel); Ariz. Rev. Stat. § 38-844.03 (applying to public safety personnel); Mich. Comp. Laws § 38.1624a (retired state police officers).

DROP plans can take a number of different forms. The details of any potential DROP option remain undefined. As such, the state actuary assessed the putative impact of a DROP plan based on the typical public safety plan. On retirement, the system would freeze benefit accrual and calculate a member's annuity based on current service accrual and final average salary. Once the member begins receiving pension payments, those payments would accumulate in a separate 'savings account,' which would accrue interest at the assumed rate of return. The assumed rate of return in Rhode Island is 7%. Once the member stops working and begins to collect their deferred retirement benefit (as calculated at DROP entry), they would be entitled to accrued interest.

The typical DROP plan would increase the employer contribution rate by 5.99% of payroll, requiring an additional $4.6 million contribution annually across municipalities participating in MERS. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. The unfunded liability for MERS units would increase by $50 million, decreasing the cumulative funded ratio by 4.5% from 86.5% to 82%.

The following table describes costs attributable to this option in greater detail:

	MERS POLICE AND FIRE UNITS
Normal Cost	2.90%
UAAL	$50 million
Funded Ratio	-4.2%
Projected FY25 Contribution	
Percent of Payroll	5.99%
Est. Annual Dollar Amount	$4.6 million

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

V. RETIREE BENEFIT ENHANCEMENTS

A. *Full or Partial COLA Restoration for ERSRI and MERS members.*

Throughout the Working Group's review process, COLAs have been the prevailing topic of testimony from retirees. Beginning in 2012, RIRSA suspended full annual COLAs until the ERSRI, SPRBT, and RIJRFT collectively reach a funded status of 80%. *See* R.I. Gen. Laws §§ 16-16-40 (f)(2); 36-10-35 (g)(2).[26] In many regards, COLA suspension has subsumed the other reforms occasioned by RIRSA for this class of public servants, for casual viewers of the Working Group's efforts, and for the media. Both the 80% target ratio and date actuarial projections anticipate the system will reach that target – now expected to occur in 2030 – carry great significance and meaning for many pensioners. Indeed, the Working Group received testimony from countless members that fear they will never receive a COLA and will never reap the future benefits of a healthy pension system.

Given the public attention and scrutiny afforded this facet of the 2011 reforms, the Working Group studied multiple options concerning full or partial COLA restoration for consideration by the General Assembly. As presented below, these options run the gambit on cost, feasibility, equity and impact. The options have been subdivided into two categories: options which would create a permanent benefit change, and temporary, 'one-time' adjustments.

BASELINE COST

Costs are expressed in addition to baseline costs and impact of expected benefit payouts. Absent any change the Fiscal Year 2025 contribution rate is expected to be 26.53% of payroll, or $544.3 million ($370.2 million paid by the state, $174.1 million paid by the municipalities).

The unfunded actuarial accrued liability is expected to be $4.495 billion dollars and the cumulative funded ratio is 62.8% as of the June 30, 2023 ERSRI valuation.

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[26] Municipal plans within MERS are considered independently. As such, a MERS unit will receive a COLA when that particular unit reaches 80% funded. R.I. Gen. Laws § 45-21-52 (c)(3). While members of ERSRI have not received a full annual COLA since 2012, many municipal employees and public safety professionals do currently receive a full annual adjustment. *See* Municipal Employees' Retirement System of Rhode Island, Actuarial Valuation Report, Table 7, June 30, 2023.

CURRENT COLA PROVISIONS

Unless otherwise specified, each option assumes the change described is the *only* benefit change. Once the system reaches 80% funded – thereby reinstating full annual COLAs for eligible members – the COLA provided in a given year is based on the following formula: half of the COLA is calculated by taking the previous 5-year average investment return, less 5% (5-year return minus – 5% with a max of 4%), and half is calculated using the increase in the Consumer Price Index for All Urban Consumers ("CPI-U") from the prior September 30 (max of 3%) for a total maximum COLA of 3.5%. *See* R.I. Gen. Laws §§ 16-16-40 (g)(1)(B); 36-10-35 (h)(1)(B); 45-21-52 (d)(1)(B). Prior to RIRSA, COLAs were fixed at 3% annually.[27] Since 2011, however, many states have followed Rhode Island and adopted a variable COLA tied to investment performance as a bulwark against future economic volatility.

Further, COLAs are capped by income. Members (and their beneficiaries) that retired after June 30, 2015 are entitled to an adjustment on the first $29,776 of their annual benefit (indexed annually). *See* Employees' Retirement System of Rhode Island, *Who is Eligible to Receive a COLA in 2024?*, accessed Feb. 14, 2024, at https://www.ersri.org/2024-cola; R.I. Gen. Laws §§ 16-16-40, 36-10-35. Members (and their beneficiaries) that retired before June 30, 2015 are entitled to an adjustment on the first $35,731 of their annual benefit (indexed annually). *See id*. Pursuant to state law, members begin receiving their COLA "on the month following the third anniversary date of retirement." R.I. Gen. Laws §§ 16-16-40, 36-10-35. Retirees therefore do not receive COLAs immediately but must wait three years. Unless otherwise specified, each option presented below presumes both statutory provisions remain unchanged.

It is worthy of mention that eligible pensioners do receive an annual adjustment. Under legislation passed during the 2023 session, retired members of ERSRI and MERS units that have not reached an 80% funded ratio[28] will receive 25% of a COLA annually until the system reaches 80% funded (expected to occur in 2030). *See* R.I. Gen. Laws §§ 16-16-40 (g)(2); 36-10-35 (h)(2); 45-21-52 (d)(2).[29]

[27] Before pension reform, "[r]etirees received a [COLA] tied to inflation and capped at 3 percent of the first $35,000 of their pensions; in other words, up to $1,050 per year." Hiltonsmith, *supra*, at 2; Pub. L. 2011, Ch. 409, § 11.
[28] As of June 30, 2022, 64 of the 122 MERS Units were receiving COLAs. *See* ERSRI Audit Fiscal Year Ended June 30, 2022, at 19, 21.
[29] Prior to January 1, 2024, eligible pensioners received an adjustment once every four years (decreased from an adjustment once every five years as part of the settlement negotiations in *Clifford v. Raimondo*, 184 A.3d 673, 681 (R.I. 2018)). *See* Pub. L. 2015, Ch. 141, art. 21, § 19.

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

PERMANENT BENEFIT ADJUSTMENTS

(1) **Restoration of a 3% compounding COLA for statutorily eligible members of ERSRI.**

This option effectively replaces the current COLA formula – which is based on investment performance and inflation – with a flat 3% compounding COLA for active and retired members of ERSRI and MERS. *See* R.I. Gen. Laws §§ 16-16-40 (g)(1)(B); 36-10-35 (h)(1)(B); 45-21-52 (d)(1)(B). Because this option is prospective in nature, it would not adjust for unissued COLAs since 2011.

This option would increase the total state and local contribution to the pension system by $75 million in Fiscal Year 2025 ($47.8 million from the state and $27.2 million from municipalities). This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is largely attributable to the increase in the employer contribution rate, which would increase by 3.66% of payroll – from 26.53% to 30.19% – as result of this change. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

Further, the unfunded liability would increase by $807 million and decrease the funded ratio by 3.9%, though under this scenario, the target funded ratio would be repealed.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS	MERS GENERAL UNITS	MERS POLICE AND FIRE UNITS
Normal Cost	0.37%	0.43%	0.37%	0.86%
UAAL	$328 million	$479 million	$72 million	$51 million
Funded Ratio	-3.7%	-4.1%	-4.4%	-4.4%
Projected FY25 Contribution				
Percent of Payroll	3.50%	3.77%	2.31%	3.66%
Est. Annual Dollar Amount	$29.6 million	$45.4 million	$6.9 million	$5.4 million

(2) **Restoration of a 3% non-compounding COLA for statutorily eligible members of ERSRI.**

This option effectively replaces the current COLA formula – which is based on investment performance and inflation – with a flat 3% non-compounding ("simple") COLA for active and retired members of ERSRI and MERS. *See* R.I. Gen. Laws §§ 16-16-40 (g)(1)(B); 36-10-35 (h)(1)(B); 45-21-52 (d)(1)(B). Because this option is prospective in nature, it would not adjust for unissued COLAs since 2011.

This option would increase the total state and local contribution to the pension system by $53.3 million in Fiscal Year 2025 ($34.1 million from the state and $19.3 million from municipalities). This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is largely attributable to the increase in the employer contribution rate, which would increase by 2.60% of payroll – from 26.53% to 29.13% – as a result of this change. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

Further, the unfunded liability would increase by $563 million and decrease the funded ratio by 2.8%, though under this scenario, the target funded ratio would be repealed.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS	MERS GENERAL UNITS	MERS POLICE AND FIRE UNITS
Normal Cost	0.31%	0.35%	0.18%	0.38%
UAAL	$230 million	$332 million	34 million	$25 million
Funded Ratio	-2.7%	-2.9%	-2.2%	-2.2%
Projected FY25 Contribution				
Percent of Payroll	2.51%	2.66%	1.09%	1.74%
Est. Annual Dollar Amount	$21.2 million	$32.2 million	$3.3 million	$2.6 million

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

(3) **Full restoration of a 3% compounding COLA for statutorily eligible members of ERSRI and MERS, with a benefit adjustment for all previously suspended COLAs.**

This option effectively replaces the current COLA formula – which is based on investment performance and inflation – with a flat 3% compounding COLA for active and retired members of ERSRI and MERS. This option is pseudo-retroactive in nature. It would *not* provide back payments for unissued COLAs. Rather, it would adjust current retiree benefits *as if* they had received a 3% COLA each year since RIRSA and provide that benefit on a go-forward basis.

This option would increase the total state and local contribution to the pension system by $169.2 million in Fiscal Year 2025 ($106.4 from the state and $62.8 from municipalities). This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is largely attributable to the increase in the employer contribution rate, which would increase by 8.25% of payroll – from 26.53% to 34.78% – as a result of this change. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

Further, the unfunded liability would increase by $1.946 billion and decrease the funded ratio by 8.7%, though under this scenario, the target funded ratio would be repealed.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS	MERS GENERAL UNITS	MERS POLICE AND FIRE UNITS
Normal Cost	0.37%	0.43%	0.37%	0.86%
UAAL	$760 million	$1.185 billion	$72 million	$51 million
Funded Ratio	-8.0%	-9.3%	-4.4%	-4.4%
Projected FY25 Contribution				
Percent of Payroll	7.63%	8.68%	2.31%	3.66%
Est. Annual Dollar Amount	$64.5 million	$104.7 million	$6.9 million	$5.4 million

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

(4) **Full restoration of a 3% compounding COLA for members of ERSRI that retired before July 1, 2012, with a benefit adjustment for all previously suspended COLAs.**

This option replaces the current COLA formula – which is based on investment performance and inflation – with a flat 3% compounding COLA *only* for members of ERSRI and MERS who retired before the effective date of RIRSA. This option is pseudo-retroactive in nature. It would *not* provide back payments for unissued COLAs. Rather, it would adjust current retiree benefits *as if* they had received a 3% COLA each year since RIRSA and provide that benefit on a go-forward basis.

This option would increase the total state and local contribution to the pension system by $110.3 million in Fiscal Year 2025 ($67.9 million from the state and $42.5 million from municipalities). This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is largely attributable to the increase in the employer contribution rate, which would increase by 5.38% of payroll – from 26.53% to 31.91% – as a result of this change. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

Further, the unfunded liability would increase by $1.333 billion and decrease the funded ratio by 6.2%, from 62.8% to 56.6%. Under this proposed change, the 80% target ratio would remain in place for those who retired after July 1, 2012. Consequently, this option will prolong COLA restoration for post-RIRSA retirees to the benefit of pre-RIRSA retirees.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS
Normal Cost	0.00%	0.00%
UAAL	$490 million	$843 million
Funded Ratio	-5.4%	-6.9%
Projected FY25 Contribution		
Percent of Payroll	4.68%	5.87%
Est. Annual Dollar Amount	$39.6 million	$70.8 million

(5) **Repeal of the 80% funded ratio for members of ERSRI that retired before July 1, 2012.**

This option would repeal the target funded ratio for members of ERSRI that made the decision to retire before the effective date of RIRSA. These members would begin receiving the COLA adjustment set out under current statutory provisions immediately. Under this proposed change, the 80% target ratio would remain in place for those who retired after July 1, 2012. Consequently, this option will prolong COLA restoration for post-RIRSA retirees to the benefit of pre-RIRSA retirees.

This option would increase the total state and local contribution to the pension system by $22.2 million in Fiscal Year 2025 ($13.8 million from the state and $8.4 million from municipalities). This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

This increase is largely attributable to the increase in the employer contribution rate, which would increase by 1.08% of payroll from 26.53% to 27.61%.

The unfunded liability would increase by $268 million and decrease the funded ratio by 1.4% from 62.8% to 61.4%.

To finance this change through general revenue on a pay-as-you-go basis, the General Assembly would need to appropriate an additional $10.3 million annually ($4.0 million for state employees, $6.3 million for teachers). Alternatively, the legislature would need to appropriate an additional $36.2 million ($13.5 million for state employees, $22.7 million for teachers) annually over a ten-year amortization period to implement this benefit enhancement without impacting the funded ratio.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS
Normal Cost	0.00%	0.00%
UAAL	$102 million	$167 million
Funded Ratio	-1.2%	-1.5%
Projected FY25 Contribution		
Percent of Payroll	0.97%	1.16%
Est. Annual Dollar Amount	$8.2 million	$14 million

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.

TEMPORARY BENEFIT ADJUSTMENTS

(1) A one-time 3% non-compounding COLA for statutorily eligible members of ERSRI.

This option would provide pensioners eligible to receive a fractional COLA under current statutory provisions a simple 3% COLA for Fiscal Year 2025. Though this adjustment is not compounding, it will increase member benefits by 3%, impacting the future benefit value. As proposed, this provision would not benefit municipal employees and public safety professionals in MERS units. Presently, municipal employees and public safety professionals are eligible to receive a COLA when their specific unit reaches 80% funded. As of the last valuation, over half of MERS units receive a COLA.

This option would increase the total state and local contribution to the pension system by $10.5 million in Fiscal Year 2025 ($6.7 million from the state and $3.8 million from municipalities). This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is largely attributable to the increase in the employer contribution rate, which would increase by 0.51% of payroll – from 26.53% to 27.04% – as a result of this change. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

Further, the unfunded liability would increase by $127 million and decrease the funded ratio by 0.7% from 62.8% to 62.1%.

To finance this change through general revenue on a pay-as-you-go basis, the General Assembly would need to appropriate an additional $15.5 million annually ($6.0 million for state employees, $9.5 million for teachers). Alternatively, the legislature would need to appropriate an additional $17.1 million ($6.9 million for state employees, $10.2 million for teachers) annually over a ten-year amortization period to implement this benefit enhancement without negatively impacting the funded ratio.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS
Normal Cost	0.00%	0.00%
UAAL	$52 million	$75 million
Funded Ratio	-0.6%	-0.7%
Projected FY25 Contribution		
Percent of Payroll	0.49%	0.52%
Est. Annual Dollar Amount	$4.2 million	$6.3 million

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(2) **A one-time COLA based on the current statutory formula for statutorily eligible members of ERSRI.**

This option would provide pensioners eligible to receive a fractional COLA under current statutory provisions a full COLA for 2024. The Fiscal Year 2024 fractional COLA – one fourth of a full COLA – is calculated to be 0.71%. Under this proposal, pensioners would instead receive a 2.71% COLA. This option will provide pensioners with some benefit to offset current inflation. Based on the impact to the funded ratio, pensioners will effectively be trading a COLA in 2024 for the COLA they are projected to receive beginning in 2030. As proposed, this provision would not benefit municipal employees and public safety professionals in MERS units. Presently, municipal employees and public safety professionals are eligible to receive a COLA when their specific unit reaches 80% funded. As of the last valuation, over half of the MERS units receive a COLA.

This option would increase the total state and local contribution to the pension system by $7.8 million in Fiscal Year 2025 ($5 million from the state and $2.8 million from municipalities).[30] This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. This increase is largely attributable to the increase in the employer contribution rate, which would increase by 0.38% of payroll – 26.53% to 26.91% – as a result of this change. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

The unfunded liability would increase by $95 million and decrease the funded ratio by 0.5% from 62.8% to 62.3%.

To finance this change through general revenue on a pay-as-you-go basis, the General Assembly would need to appropriate an additional $11 million annually ($4.3 million for state employees, $6.7 million for teachers). Alternatively, the legislature would need to appropriate an additional $12.8 million ($5.2 million for state employees, $7.6 million for teachers) annually over a ten-year amortization period to implement this benefit enhancement without negatively impacting full COLA restoration. The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS
Normal Cost	0.00%	0.00%
UAAL	$39 million	$56 million
Funded Ratio	-0.5%	-0.5%
Projected FY25 Contribution		
Percent of Payroll	0.37%	0.39%
Est. Annual Dollar Amount	$3.1 million	$4.7 million

[30] Though this is a one-time adjustment, it will increase member benefits by 2.71%, impacting the future benefit value.

(3) **A one-time 3% compounding COLA for statutorily eligible members of ERSRI.**

This option would provide pensioners eligible to receive a fractional COLA under current statutory provisions a 3% compounding COLA for Fiscal Year 2025. This adjustment is compounding. Consequently, this provision has a larger cost because it will impact future annual benefits. This option will provide pensioners some benefit to offset current inflation but is short-term in nature. Based on the impact to the funded ratio, pensioners will effectively be trading a COLA in 2024 for the COLA they are projected to receive beginning in 2030. As proposed, this provision would not benefit municipal employees and public safety professionals in MERS units. Presently, municipal employees and public safety professionals are eligible to receive a COLA when their specific unit reaches 80% funded. As of the last valuation, over half of the MERS units receive a COLA.

This option would increase the total state and local contribution to the pension system by $11.3 million in Fiscal Year 2025 ($7.2 million from the state and $4.1 million from municipalities). This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

This increase is largely attributable to the increase in the employer contribution rate, which would increase by 0.55% of payroll from 26.53% to 27.08%.

The unfunded liability would increase by $137 million and decrease the funded ratio by 0.7% from 62.8% to 62.1%.

To finance this change through general revenue on a pay-as-you-go basis, the General Assembly would need to appropriate an additional $15.5 million annually ($6.0 million for state employees, $9.5 million for teachers). Alternatively, the legislature would need to appropriate an additional $18.5 million ($7.5 million for state employees, $11 million for teachers) annually over a ten-year amortization period to implement this benefit enhancement without impacting full COLA restoration.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS
Normal Cost	0.00%	0.00%
UAAL	$56 million	$81 million
Funded Ratio	-0.7%	-0.7%
Projected FY25 Contribution		
Percent of Payroll	0.53%	0.56%
Est. Annual Dollar Amount	$4.5 million	$6.8 million

(4) **A one-time 2% compounding COLA for statutorily eligible members of ERSRI.**

This option would provide pensioners eligible to receive a fractional COLA under current statutory provisions a simple 2% COLA for Fiscal Year 2025. This adjustment is compounding. Consequently, this provision has a larger cost because it will impact future annual benefits. This option will provide pensioners some benefit to offset current inflation but is short-term in nature. Of note, this COLA would be less than the statutory calculated COLA for this fiscal year. The statutory calculated COLA would be 2.71%. As proposed, this provision would not benefit municipal employees and public safety professionals in MERS units. Presently, municipal employees and public safety professionals are eligible to receive a COLA when their specific unit reaches 80% funded. As of the last valuation, over half of the MERS units receive a COLA.

This option would increase the total state and local contribution to the pension system by $7.3 million in Fiscal Year 2025 ($4.7 million from the state and $2.6 million from municipalities). This figure represents the *annual* budgetary increase attributable to this change. Since the change is expressed as a percentage of payroll, it will increase over the 20-year statutory amortization period for the unfunded liability. The local contribution is comprised of each municipality's contribution to MERS and its 60% share of the teacher contribution rate. *See* R.I. Gen. Laws § 16-16-22 (a).

This increase is largely attributable to the increase in the employer contribution rate, which would increase by 0.36% of payroll from 26.53% to 26.89%.

The unfunded liability would increase by $88 million and decrease the funded ratio by 0.5% from 62.8% to 62.3%.

To finance this change through general revenue on a pay-as-you-go basis, the General Assembly would need to appropriate an additional $10.3 million annually ($4.0 million for state employees, $6.3 million for teachers). Alternatively, the legislature would need to appropriate an additional $11.9 million ($4.8 million for state employees, $7.1 million for teachers) annually over a ten-year amortization period to implement this benefit enhancement without impacting full COLA restoration.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS
Normal Cost	0.00%	0.00%
UAAL	$36 million	$52 million
Funded Ratio	-0.5%	-0.5%
Projected FY25 Contribution		
Percent of Payroll	0.35%	0.36%
Est. Annual Dollar Amount	$2.9 million	$4.4 million

B. *Reduce the target funded ratio from 80% to 75% or 70% for reinstatement of statutory benefits.*

The RIRSA suspended full annual COLAs until the ERSRI, SPRBT, and RIJRF collectively reach a funded status of 80%. *See* R.I. Gen. Laws §§ 16-16-40 (f)(2); 36-10-35 (g)(2); 45-21-52 (c)(3) (providing that COLAs are suspended for each municipal plan until the funded ratio of that municipal plan reaches 80% funded).

"A plan's funded ratio, which equals the value of assets in a pension plan divided by a measure of its obligations" is a "financial snapshot of a plan's status at a single moment." American Academy of Actuaries, *The 80% Pension Funding Myth* (Jul. 2012), accessed Feb. 14, 2024, at https://www.actuary.org/node/13461. There is some scholarly debate concerning the funded ratio of a healthy pension plan. *See id*; Girard Miller, *Pension Puffery*, Governing Magazine (Jan. 2012). There is evidence that eighty percent is a generally accepted threshold in both public and private pension systems. Indeed, the Working Group has considered testimony that public pension plans across the United States were approximately 71% funded in 2022, with the majority over 80% funded. As of 2021, only six states maintained a lower funded ratio than Rhode Island.

Contemporary sources from the time of reform indicate the Office of the General Treasurer relied on the federal Pension Protection Act of 2006 as a guide. In passing the Act, Congress found a plan's funded ratio to be "a general indicator of a pension plan's health at a specific point in time." Keith Brainard and Paul Zorn, *The 80-percent threshold: Its source as a healthy or minimum funding level for public pension plans*, National Association of State Retirement Administrators, at 1 (Jan. 2012). As explained in a 2008 report published by the United States Government Accountability Office,

> The Pension Protection Act of 2006 provided that large private sector pension plans will be considered at risk of defaulting on their liabilities if they have less than 80 percent funded ratios under standard actuarial assumptions and less than 70 percent funded ratios under certain additional 'worst-case' actuarial assumptions. When private sector plans default on their liabilities, the Pension Benefit Guaranty Corporation becomes liable for benefits. These funding standards will be phased in, becoming fully effective in 2011, and at-risk plans are required to use stricter actuarial assumptions that will result in them having to make larger plan contributions.

United States Government Accountability Office, *State and Local Government Retiree Benefits: Current Funded Status of Pension and Health Benefits* (Jan. 2008) (citing Pub. L. 109-80, Aug. 17, 2006, 120 Stat. 780). Relative merits of the target ratio aside, the 80% funded threshold has become synonymous with the 2011 reforms, particularly for pensioners eagerly awaiting the return of full annual COLAs.

Currently, ERSRI (state employees) is funded at 60.4%, ERSRI (teachers) is funded at 64.5%, the SPRBT is funded at 85.5%, and the RIJFT is funded at 102.3%. *See* ERSRI Actuarial Valuation Report as of June 30, 2023, at 2; SPRBT Actuarial Valuation Report as of June 30, 2023, at 1;

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Judicial Retirement Benefits Trust Actuarial Valuation Report as of June 30, 2023, at 2. Collectively, ERSRI, SPRBT, and RIJFT are 62.8% funded. On the eve of pension reform, the unfunded liability was 48.4%. The state actuary projects that the plan will reach the 80% target ratio by 2030, one year earlier than projected in 2011.

Over the course of several hearings, multiple stakeholders have recommended the Working Group consider testimony recommending the legislature amend the 80% funded goal set by RIRSA. This option would decrease the target funded ratio to either 75% or 70%, returning benefits sooner. Both changes carry a cost since they will add a benefit (*i.e.,* an extra COLA or COLAs) not presently anticipated.

The system is presently projected to reach 75% funded in 2029. Therefore, a premature benefit restoration at 75% will occasion one additional COLA. That additional benefit will increase the total state and local contribution to ERSRI by $5.4 million ($3.8 million from the state and $1.6 million from municipalities). This cost is attributable to the increased employer contribution rate, which will rise by 0.26% from 26.53% to 26.79%. The unfunded actuarial accrued liability will increase by $65 million, decreasing the funded ratio by 0.3%.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS
Normal Cost	0.00%	0.00%
UAAL	$33 million	$32 million
Funded Ratio	-0.4%	-0.3%
Projected FY25 Contribution		
Percent of Payroll	0.32%	0.22%
Est. Annual Dollar Amount	$2.7 million	$2.7 million

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The system is presently projected to reach 70% funded in 2028. Therefore, a premature benefit restoration at 70% would occasion two additional COLAs. That added benefit would increase the total state and local contribution to ERSRI by $10.5 million ($7.3 million from the state and $3.2 million from municipalities). This cost is attributable to the increased employer contribution rate, which would rise by 0.51% from 26.53% to 27.04%. The unfunded actuarial accrued liability will increase by $128 million, decreasing the funded ratio by 0.7%.

The following table describes costs attributable to this option in greater detail. Costs have been separated by unit:

	STATE EMPLOYEES	TEACHERS
Normal Cost	0.00%	0.00%
UAAL	$65 million	$63 million
Funded Ratio	-0.8%	-0.6%
Projected FY25 Contribution		
Percent of Payroll	0.62%	-0.6%
Est. Annual Dollar Amount	$5.2 million	$5.3 million

Under either option, pensioners would continue to receive the annual fractional-COLAs prescribed under prevailing law until the system reaches the new target ratio.

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VI. OTHER CONSIDERATIONS

A. *Separate legacy debt and legacy unfunded liability from that associated with active members of ERSRI.*

Legacy debt refers to unfunded pension liabilities "from a bygone era," generally accrued before modern actuarial funding began. Jean-Pierre Aubry, *Forensic Analysis of Pension Funding: A Tool for Policymakers*, Center for Retirement Research at Boston College, No. 83 (Apr. 2022), at 3. "Legacy debt has never fit well within the modern [pension] framework because it stems from a much earlier era and its burden cannot be reasonably allocated to those who should have borne the costs." *See id.* In 2022, a report issued by the Center for Retirement Research at Boston College estimated that legacy debt represented 17% of Rhode Island's total unfunded actuarial accrued liability ($.9 billion of $5.3 billion). *See id.*

Separating legacy debt and legacy unfunded liability from that associated with active members of ERSRI would not impact expected costs. Legacy debt must be paid *regardless* of whether it is 'separated.' Instead, this option represents a change in how costs are budgeted and communicated.

Currently, the state actuary determines the employer contribution rate by adding the scheduled amortization payment divided by projected payroll to the normal cost, which is expressed as a percentage of payroll. By processing amortization cost as a percent of payroll, employers can more easily ascertain the cost of a new employee from a budgetary perspective. The pension cost of hiring an employee would be that employee's annual salary multiplied by the employer contribution rate.

To separate legacy debt, the employer amortization payment would be budgeted and paid as a set dollar amount, rather than as a component of the employer contribution rate. The employer contribution rate would decrease significantly since it would no longer account for the annual amortization payment, but the employer must still pay the scheduled amortization payment associated with legacy debt.

B. *Create a state-sponsored annuity plan for retirees administered by ERSRI.*

In December 2023, ERSRI introduced a product – referred to as TIAA RetirePlus – permitting members to annuitize their DC plan benefits, should they choose.

However, the Working Group considered an option which would permit members to annuitize their DC balance into the DB plan upon retirement. Private financial services organizations such as TIAA (which manages the state DC plan) price services based on market interest rates, shorter time horizons, mortality risk, and net profit margins. If members were offered the opportunity to annuitize their DC contributions through their existing DB plan, the state could offer pricing based on a 6% fixed interest rate,[31] minimally margined mortality risk, and comparatively little administrative cost. By annuitizing the DC benefit through the DB plan, the system could provide a 2% expected COLA (though the actual adjustment would be fixed to investment returns, similar

[31] The assumed rate of return is currently 7% for the DB plan. *See* ERSRI Actuarial Experience Investigation for the Period Ending June 30, 2022, at 13.

to a portion of the current COLA formula). Under this option, the state actuary testified that even in low return environments where the COLAs were lower than the expected 2%, members would yield a guaranteed 4% return (which is either greater than or equal to that provided in the private market). In addition, each cohort of new retirees would not have the risk of what market interest rates will be once they are eligible to retire.

Further, the state could implement this change with limited risk to the funded status of ERSRI, since the DB plan would likewise benefit from this option as long as the system maintains over 4% returns. The state actuary indicated this option would increase the value of the DC benefit by at least 15% with little to no cost to the state.

C. *Exempt public pension benefits from state income tax.*

In his submitted budget, Governor Dan McKee proposed legislation which would raise the exemption for taxable retirement income from $20,000 to $50,000 starting in tax year 2025. The Governor's Office projects this change would save in-state pensioners $3.0 million in Fiscal Year 2025 and $6.2 million in Fiscal Year 2026.

D. *Create a "pension benefit floor" tied to the federal poverty line.*

Under this proposal, annual benefits of those who fall below this line would be supplemented through annual appropriation by the General Assembly. This option would ensure the state's most vulnerable pensioners retain a livable retirement income but may be difficult for the General Assembly to project and budget each year. Also, this would likely reward low-service members as the benefit is tied to the amount of service earned.

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E. *Raise income for active members of ERSRI and MERS*

The Working Group heard testimony concerning several options outside the purview of the Groups legislative charge – which was expressly tied to RIRSA – but that would nonetheless increase income for active members of ERSRI and MERS. In the spirit of transparency, we have included those options as part of the Report:

(1) **Increase salaries for active teachers, state employees, and municipal employees;**
(2) **Reduce the cost of health insurance to active teachers, state employees and municipal employees;**
(3) **Restore longevity payments to active teachers and state employees; and/or** [32]
(4) **Reduce the member contribution rate into the DB plan.**

[32] Teachers and state employees do not receive longevity payments under prevailing law. *See* R.I. Gen. Laws §§ 36-4-17.2; 16-59-7.2. Previously, teachers were entitled to a 5% increase of their base salary after 10 years of service, increasing to 10% of their base salary after 20 years of service. *See* R.I. Gen. Laws § 16-59-7.2; Pub. L. 2011, Ch. 151, art. 8, § 2. While longevity payments for state employees were enabled under state law, the specific benefit was subject to collective bargaining agreements. *See* R.I. Gen. Laws § 36-4-17.1; Pub. L. 2011, Ch. 151, art. 8, § 1. State employees were entitled to a 5% increase of their base salary after 5 years of service, a 10% total increase after 11 years of service, a 15% total increase after 15 years, a 17.5% total increase after 20 years, and a 20% total increase after 25 years. Master Agreement between State of Rhode Island and Rhode Island Council 94, AFSCME AFL-CIO, Section 6.4, July 1, 2008, through June 30, 2012. Longevity payments were *not* impacted by RIRSA.

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Actuarial Accrued Liability – The total liability for all past services rendered by retired and active plan members (known as the actuarial accrued liability) is determined by taking the present value of all future plan benefits and subtracting the present value of all future normal costs. *See* ERSRI Actuarial Experience Investigation for the Period Ending June 30, 2022, at 36. Since the normal cost is designed to pick up all future costs of active members, the calculation of the actuarial accrued liability is for past services only.

Actuarial Cost Method – To address the gap between expectation and reality, actuaries use a method known as the actuarial cost method to account for any variance and ensure the plan makes mid-course adjustments. *See* R.I. Gen. Laws §§ 36-10-2.1, 45-21-43.1 (requiring use of the actuarial cost method).

In Rhode Island, the plan uses the actuarial cost method known as entry age normal ("EAN") to make these adjustments. *See* ERSRI Actuarial Experience Investigation for the Period Ending June 30, 2022, at 36. The EAN method is the preferred method for public plans and is required by Rhode Island statute. *See id*. at 3, 33. The primary purpose of any actuarial cost method, EAN included, is to design a funding program that calculates contributions for both the normal cost (the cost of future benefits) and the cost for prior service benefits *not funded* by the normal cost. *See id*. at 36. The cost for past benefits not funded by the normal cost is known as the unfunded liability. *See, infra*. Put another way, the unfunded liability is the accumulation of actuarial losses occurring in the plan over time.

Under the EAN method, the actuary first determines all future pension benefits to be paid to retired members and active members. *See* ERSRI Actuarial Experience Investigation for the Period Ending June 30, 2022, at 36. For retired members, the actuary determines future benefits based on 3 main factors: (i) the amount of pension benefit paid to each retired member, (ii) any projected COLA increases, and (iii) the life expectancies of the retired members as determined by the actuary. *See id.* For active members, the calculation of future benefits is similar, but it also depends on calculations of predicted salary increases, job turnover, expected retirement ages among other considerations. *See id.*

Actuarial Gains and Losses – If the actuary accurately predicts investment returns, salary increases, dates of retirement, life expectancies and all other actuarial assumptions, a public pension plan will be fully funded – and no other contributions would be required – assuming the state makes the specified annual normal cost contributions.

However, actuarial assumptions are rarely – if ever – correct. If an actuarial assumption is wrong, for example if a plan has an investment return lower than the assumed investment return, there will be an actuarial "loss," which has to be made up by *additional* contributions in future years. Conversely, if a plan has investment returns which exceed its assumed investment return, the plan will have an actuarial "gain," and will have a surplus which has the effect of *reducing* future contributions.

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Actuarial gains and losses are also created by real life experience that differs from *each* actuarial assumption a plan relies on, such as when salary increases are higher or lower than expected, when people's life expectancies are longer or shorter than expected, or when workers retire earlier or later than expected. *See* ERSRI Actuarial Experience Investigation for the Period Ending June 30, 2022, at 6. To the extent that actuarial assumptions are wrong, they create either an actuarial loss or actuarial gain. *See id.*

Actuarial losses and gains are also created when the benefits of a plan are changed if these new benefits apply to an employee's *prior* years of service. If benefit improvements are applied to prior years of service, these benefits would not have been calculated as part of the normal cost for those prior years.

Accordingly, such benefit improvements create an actuarial loss, which must be made up by additional contributions in future years. Conversely, if benefits are decreased for prior years of service, actuarial gains are produced which will *decrease* future costs.

Amortization Period and Amortization Cost – To spread the cost of the unfunded liability over a period of time, a plan chooses an amortization period during which it will pay off its unfunded liability. The unfunded actuarial accrued liability from the 2011 pension reform is being amortized over a closed 25-year period from June 30, 2010. *See* ERSRI Actuarial Experience Investigation for the Period Ending June 30, 2022, at 32. The remaining amortization period is 12 years. *See id*. The amortization cost is then calculated as the amount that will be sufficient to pay off the unfunded liability over the amortization period. *See* ERSRI Actuarial Experience Investigation for the Period Ending June 30, 2022, at 37. State law requires any new actuarial gains and losses occurring within a plan year to "be amortized over individual new twenty (20) year closed periods." *See* R.I. Gen. Laws §§ 36-10-2.1, 45-21-43.1.

Annual Pension Cost – To determine the annual cost of the pension plan in Rhode Island, the actuary simply adds the normal cost and the amortization cost. The annual pension cost is also known as the annual required contribution (colloquially known as the "ARC").

The annual pension cost or ARC for ERSRI can be calculated as follows:

Annual normal cost

plus
Amortization cost (annual amount required to pay off the unfunded liability over the amortization period)

equals
Annual pension cost or ARC

Asset Smoothing – Because financial markets are turbulent and values fluctuate, most public plans – Rhode Island included – use a methodology called "smoothing" to value their assets. *See* ERSRI Actuarial Experience Investigation for the Period Ending June 30, 2022, at 31. In Rhode Island, our plans use a five-year smoothing method that starts with the market value of assets but phases

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in the asset gains and losses above or below the assumed discount rate over a five-year period. *See id.* Asset smoothing helps dampen market volatility when budgeting future pension costs. *See id.*

Contribution Rate – The fiscal year 2023 employer contribution rates are based on annual actuarial valuations. *See* ERSRI Audit Fiscal Year Ended June 30, 2022, at 11. The employer contribution rates for the DB plan for fiscal year 2023 are 28.01% for state employees, 26.16% for Teachers, 24.16% for Judges, and 20.87% for State Police. *See id.* Employers contribute 1% to the DC plan by statute (3% for teachers or MERS non-police or fire employees not covered by Social Security). *See* RI 401(a) Adoption Agreement, executed Jun. 29, 2012. By statute, employees contribute 5% of their annual salary to the DC plan and 3.75% of their annual salary to the DB plan. *See* ERSRI Audit Fiscal Year Ended June 30, 2022, at 11; RI 401(a) Adoption Agreement, executed Jun. 29, 2012. Teachers who are not covered by Social Security must contribute 7% of their compensation to the DC plan. *See* ERSRI Audit Fiscal Year Ended June 30, 2022, at 27; RI 401(a) Adoption Agreement, executed Jun. 29, 2012.[33]

Cost of Living Adjustment ("COLA") – RIRSA suspended full annual COLAs until the ERSRI, SPRBT, and JRBT plans collectively reach a funded status of 80%. Once returned, the COLA calculation is represented by the following formula: 50% of the COLA is calculated by taking the previous 5-year average investment return, less 5% (5-year return minus – 5.0% with a max of 4%) and 50% calculated using the increase in the Consumer Price Index for All Urban Consumers ("CPI-U") from the prior September 30 (max of 3%) for a total maximum COLA of 3.5%. *See* R.I. Gen. Laws §§ 16-16-4 (g)(1)(B); 36-10-35 (h)(1)(B); 45-21-52 (d)(1)(B). Under legislation passed during the 2023 session, retired members of ERSRI and MERS units that have not reached an 80% funded ratio[34] will receive .25% of the annual COLA until the system reaches 80% funded. *See* R.I. Gen. Laws §§ 16-16-4 (g)(2); 36-10-35 (h)(2); 45-21-52 (d)(2).

For members (and their beneficiaries) that retired after June 30, 2015, the annual benefit adjustment provided in any calendar year is equal to the lesser of either the member's retirement allowance or a base amount of $29,776 (indexed annually as prescribed in law, depending on type of service) multiplied by the percent resulting from the COLA calculation. *See*, Employees' Retirement System of Rhode Island, *Who is Eligible to Receive a COLA in 2024?*, accessed Feb. 14, 2024, at https://www.ersri.org/2024-cola; R.I. Gen. Laws §§ 16-16-40, 36-10-35.

For members (and their beneficiaries) that retired before June 30, 2015, the annual benefit adjustment provided in any calendar year is equal to the lesser of either the member's retirement allowance or a base amount of $35,731 (indexed annually as prescribed in law, depending on type of service) multiplied by the percent resulting from the COLA calculation. *See id.*

Defined Benefit – Under a defined benefit plan, an employer "promises to pay employees a certain level of retirement benefits based on factors such as the age of the participant, length of employment, salary history and other criteria, calculated according to a predetermined formula." Betty Linn Krikorian, *Fiduciary Standards in Pension and Trust Fund Management* (1989) at

[33] Note, these are *pre-tax* dollars. *See* RI 401(a) Adoption Agreement, executed Jun. 29, 2012.
[34] As of June 30, 2022, 64 of the 122 MERS Units were receiving COLAs. *See* ERSRI Audit Fiscal Year Ended June 30, 2022, at 19, 21.

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40. In a defined benefit plan, the employer – rather than the employee – "bears the risk of lower than anticipated investment earnings and reliance on actuarial or business forecasts, since the employer will be obliged to make up any shortfalls in funding needed to provide retiring workers with the promised benefits." *Id*. Consequently, defined benefit plans provide a more "secure, predictable, and adequate retirement income [ ]." Hiltonsmith, *supra*, at 3.

ERSRI administers seven defined benefit pension plans. State employees and teachers are combined into one cost-sharing plan while teachers' survivors benefits are provided from an additional cost sharing plan. *See* ERSRI Audit Fiscal Year Ended June 30, 2022. Two plans cover state police, and two additional plans cover judges. *See id.* Municipal employees are covered under a separate agent plan administered by the System. *See id*.

Defined Contribution – In a defined contribution plan, "a separate account is created for each participant and both employer and employee contributions (depending on the type of plan) are allocated to the account." Krikorian, *supra*, at 40. "All of the accounts in a plan share proportionally in the plan's gains, losses, expenses, and investment outcome." *Id.* "The benefits a retiree receives are based solely on the amount accumulated in his or her individual account and not on the employer's promise of a certain level of benefits." *Id.* The employee's contributions to the plan "vest immediately." *Id*.; ERSRI Audit Fiscal Year Ended June 30, 2022, at 27. In Rhode Island, employer contributions vest after five years of service. *See* ERSRI Audit Fiscal Year Ended June 30, 2022, at 16.

As of June 30, 2022, the state defined contribution plan included 179 employers and 40,442 plan participants. *See* ERSRI Audit Fiscal Year Ended June 30, 2022, at 16.

Discount Rate/Investment Return – The actuary adds up the projected future benefits for retired members and active employees and applies a "discount rate" to determine the present value of all future benefits. In Rhode Island, the discount rate[35] is 7.0 percent (lowered from 8.25 percent in the wake of pension reform). *See* ERSRI Actuarial Experience Investigation for the Period Ending June 30, 2022, at 13; ERSRI Audit Fiscal Year Ended June 30, 2022, at 11.

The actuary next takes the normal cost (i.e. the cost of providing future benefits for active employees), projects all *future* normal costs, and then applies the discount rate to determine the present value of all future normal costs.

Normal Cost – The normal cost (sometimes referred to as the "service cost") represents the value of *new* benefits being earned. Consequently, it represents the amount of the annual contribution required to meet the cost of all pension benefits earned in current and future years. To calculate the normal cost, an actuary first projects the amount of future pensions payable to members based on (i) the benefits provided by the plan and (ii) a host of factors including, *inter alia*, the members' predicted future service, salary increases, retirement date, job turnover, and mortality.[36] *See* ERSRI Actuarial Experience Investigation for the Period Ending June 30, 2022, at 33. The actuary then determines a contribution rate that will meet the annual cost of providing future benefits. *See*

[35] In the context of Rhode Island's public pension plan, the terms "discount rate" and "investment return rate" have the same meaning and can be used interchangeably.

[36] Consequently, normal cost estimates are dependent upon current assumptions being met.

id. In Rhode Island, the normal cost is expressed as a percent of employee salary. *See id*. Any option which increases the normal cost would be permanent, meaning it would continue each year in perpetuity.

<u>Unfunded Actuarial Accrued Liability</u> – The unfunded actuarial accrued liability ("UAAL") is determined by taking the actuarial accrued liability (which is the present value of the total liability for past services) and subtracting from it the value of the assets in the plan, as determined by asset smoothing. *See* ERSRI Actuarial Experience Investigation for the Period Ending June 30, 2022, at 36. As such, any increase in this value represents an increase in the value of benefits earned in the past, even though payments will occur in future years. Each option impacting the UAAL will be amortized over a twenty-year fixed period, as required under state law. *See* R.I. Gen. Laws §§ 36-10-2.1, 45-21-43.1.

The unfunded liability can be calculated by the following formula:

All future pension payments reduced to present value (using discount rate)

minus
All future normal costs reduced to present value (using discount rate)

minus
Actuarial Value of Assets

equals
Unfunded Liability

Options assessed herein do not constitute recommendations of the Pension Advisory Working Group, or of the Office of the General Treasurer.