GRS Gabriel Roeder Smith & Company
Consultants & Actuaries

5605 N. MacArthur Blvd.
Suite 870
Irving, TX 75038-2631

469.524.0000 phone
469.524.0003 fax
www.gabrielroeder.com

PRIVATE AND CONFIDENTIAL

April 12, 2010

Honorable Steven M. Costantino
Chair, House Finance Committee
RI House of Representatives
306 State House
Providence, RI 02903

Re: Cost Analysis of Proposed Change to COLA for Current Non-grandfathered Members – Limit COLA to First $35,000 of the Annual Retirement Benefit (Indexed); Delay Commencement of COLA until Age 65; Change UAAL Amortization Period to 25 Years

Dear Mr. Costantino:

As you requested, and as authorized by the Retirement Board of the Employees' Retirement System of Rhode Island (ERSRI), enclosed are two exhibits comparing the FY 2010 employer contributions, both the contribution rates and dollar amounts, under the COLA proposal analyzed in our letter dated April 8, 2010, using either a 20-year amortization of the unfunded actuarial accrued liability (UAAL) or using a 25-year amortization period. One exhibit shows the results for State Employees (Exhibit S) while the other exhibit shows the results for Teachers (Exhibit T). Our analysis is limited to these two groups.

Proposal

This work was prepared using the same COLA proposal analyzed in our letter dated April 8, 2010. That is, this reflects the following proposed changes to the COLA:

- The first COLA would be paid at the later of the member's third anniversary of retirement and the month following their 65^{th} birthday

- The COLA would be limited to the first $35,000 of annual pension. This limit would be indexed annually to increase in the same manner as COLAs for Schedule B members (CPI for the year, not greater than 3.0%).

These changes would not apply to members who were already eligible to retire as of the date of enactment of the bill (the grandfathered group). The COLA for non-grandfathered members would continue to be computed as a compounded COLA, with the increase equal to the increase in the CPI, but no more than 3.00% per year.

Amortization

As you know, the employer contributions for ERSRI consist of (a) the employer normal cost (the normal cost less the member contribution), plus (b) a payment to amortize the UAAL. Currently, the amortization payment is determined using a closed amortization period of 30 years from July 1, 1999. Therefore, as of July 1, 2009, the beginning of FY 2010, the period had been reduced to 20 years. Payments are computed as a level percentage of payroll.

The latest proposal would require that the period be changed to 25 years for FY 2010. The period would then decrease in subsequent years. Making this change would reduce payment requirements currently, but would require making the payments for five additional years.

It is worth noting that the proposed COLA changes reduce the plan's liability, while lengthening the amortization period has no impact on the liability, it only changes the financing of the liability.

Analysis

The results of our analyses are shown in the enclosed exhibits. The first exhibit provides the cost impact for the State Employees (Exhibit S); the second presents the same information for the Teachers (Exhibit T).

Alternative 1 shows the effect of the COLA change alone. This is the same information shown in out earlier letter. Alternative 2 shows the effect of making the COLA change and lengthening the amortization period. Note that the amounts shown as the "Change" are the change from the current plan. Therefore, for State Employees, the $21.0 million savings in the FY 2010 contribution amount can be apportioned as follows:

- $5.1 million is due to the COLA change
- $15.9 million is due to the amortization change

Readers should also keep in mind that any savings for Teachers is shared between the State (40%) and the municipal employers (60%).

Data and Assumptions

To prepare this analysis, we used member and financial data supplied by ERSRI as of June 30, 2008. The data for State Employees was then further adjusted to reflect the known "Article 4" retirements that had occurred as of September 30, 2008.

Our analysis also assumes that none of the State Employee positions vacated due to the Article 4 retirements will be filled. To the extent that some of these positions are filled, the contribution as a percentage of payroll will remain relatively unchanged; however, we would expect the dollar amount of the contribution to be slightly larger (i.e. a slightly larger than expected payroll).

Other General Comments

This letter is intended to describe the financial and actuarial effect of the proposed plan change on State Employees and Teacher members of ERSRI only.

It is imperative to note that since there is a two-year lag between the actuarial valuation and the date the contributions set by the valuation become effective, and the actuarial valuation utilizes an asset smoothing method, the contribution rates shown herein do not reflect the investment losses that have occurred since June 30, 2008. Therefore, contribution rates for FY 2012 and later will almost certainly increase from current levels as these investment losses are realized.

Our calculations are based upon assumptions regarding future events, which may or may not materialize. Please bear in mind that actual results could deviate significantly from our projections, depending on actual plan experience.

Nothing in this letter should be construed as providing legal, investment or tax advice. It may be prudent to consult with the ERSRI plan counsel regarding this proposed change before enactment. Finally, no statement in this letter is intended to be interpreted as a recommendation in favor of the change studied herein or in opposition to it.

We certify that the undersigned are members of the American Academy of Actuaries and that we meet the Qualification Standards of the American Academy of Actuaries to render the actuarial opinion contained herein. If you have any questions, or require any additional or clarifying information, please do not hesitate to contact either one of the undersigned.

Respectfully submitted,
Gabriel, Roeder, Smith & Company

Mark R. Randall

Mark R. Randall
Executive Vice President

J. Christian Conradi

J. Christian Conradi
Senior Consultant

Enclosures

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Exhibit S

Employees' Retirement System of Rhode Island – State Employees
Alternative with a $35,000 COLA Eligible Dollar Limit (Indexed)
Results Shown with 20 and 25 Year Amortization Periods

Cost Analysis	**Current Plan**	**Alternative 1**	**Alternative 2**
Changes to Benefit Provisions	3rd Anniversary	Later of 3rd Anniversary or Age 65	Later of 3rd Anniversary or Age 65
	Compounded COLA	Compounded COLA	Compounded COLA
	No Limit	Limit to first $35,000	Limit to first $35,000
Period for Amortizing the Unfunded Actuarial Accrued Liability for FY 2010 (Closed)	20 Years	20 Years	25 Years
1.a. Contribution rate for FY 2010	21.64%	20.78%	18.09%
1.b. Change		**-0.86%**	**-3.55%**
2.a. Projected FY 2010 payroll	$ 590.5	$ 590.5	$ 590.5
2.b. Projected contribution	127.8	122.7	106.8
2.c. Change		**(5.1)**	**(21.0)**
3.a. Normal cost percentage	9.62%	9.26%	9.26%
3.b. Change		-0.36%	-0.36%
4.a. Unfunded actuarial accrued liability	$ 1,671.5	$ 1,631.1	$ 1,631.1
4.b. Change		(40.4)	(40.4)
5. Funded ratio	61.8%	62.3%	62.3%

Above $ amounts are in millions

Exhibit T

Employees' Retirement System of Rhode Island – Teachers
Alternative with a $35,000 COLA Eligible Dollar Limit (Indexed)
Results Shown with 20 and 25 Year Amortization Periods

Cost Analysis	**Current Plan**	**Alternative 1**	**Alternative 2**
Changes to Benefit Provisions	3rd Anniversary	Later of 3rd Anniversary or Age 65	Later of 3rd Anniversary or Age 65
	Compounded COLA	Compounded COLA	Compounded COLA
	No Limit	Limit to first $35,000	Limit to first $35,000
Period for Amortizing the Unfunded Actuarial Accrued Liability for FY 2010 (Closed)	20 Years	20 Years	25 Years
1.a. Contribution rate for FY 2010	20.07%	19.01%	16.58%
1.b. Change		**-1.06%**	**-3.49%**
2.a. Projected FY 2010 payroll	$ 1,027.8	$ 1,027.8	$ 1,027.8
2.b. Projected contribution	206.3	195.4	170.4
2.c. Change		**(10.9)**	**(35.9)**
3.a. Normal cost percentage	10.53%	10.00%	10.00%
3.b. Change		-0.53%	-0.53%
4.a. Unfunded actuarial accrued liability	$ 2,660.5	$ 2,587.0	$ 2,587.0
4.b. Change		(73.5)	(73.5)
5. Funded ratio	60.3%	61.0%	61.0%

Above $ amounts are in millions