Recommendations to the Governor and General Assembly

Local Pension & OPEB Study Commission

January 2015

January 9, 2015

The Honorable Gina M. Raimondo, Governor of Rhode Island
The Honorable Nicholas A. Mattiello, Speaker of the House
The Honorable M. Teresa Paiva-Weed, Senate President
Rhode Island State House
Providence, RI 02903

Dear Governor Raimondo, Speaker Mattiello and President Paiva-Weed:

As chairperson of the Locally-Administered Pension and OPEB Study Commission, I respectfully submit the Commission's recommendations to you for consideration. The Commission was established as part of the 2011 pension reform to review existing legislation and pension plan administrative practices and to make recommendations for the improved security and funding of locally-administered pension and other post-retirement benefit obligations of local entities. After many months of education, meetings, reviewing data, reports and testimony, the time has come to provide you with recommendations, among them the need for continued long-term oversight. The need to understand the diversity in local plans was imperative. We have listened carefully and attentively to local plan sponsors and governing bodies so that our recommendations would be responsive to the needs of plan participants, municipalities and the state.

The data we reviewed in the course of our meetings was complex. We were fortunate to have actuary Dan Sherman and a dedicated staff in the Division of Municipal Finance to break down the numbers and help us pause to put them in context. We are cognizant of our responsibility and the needs of the plan participants whose lives are touched by our actions.

I especially wish to thank the members of the commission for their time and effort as well as their honest expression of opinion for the benefit of all local plan participants. Even in moments of spirited discussion or disagreement, there has always been a tone of respect and courtesy throughout the proceedings. These proceedings, which were recorded on Capitol TV, can be viewed at http://ricaptv.discovervideo.com/view/search?c=All&k=pension&s=1. The agenda and attachments can be found at http://sos.ri.gov/openmeetings//?page=view_entity&id=5985.

I hope that you consider the recommendations put forth as we move into the new legislative session. If you have any questions regarding the recommendations, please do not hesitate to contact me.

Sincerely,

Rosemary Booth Gallogly

Rosemary Booth Gallogly
Chairperson of the Pension & OPEB Study Commission

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Commission Members

Rosemary Booth Gallogly, Chair	Department of Revenue
Jean Bouchard	AFSCME, Council 94
Mark Dingley/Melissa Malone	General Treasurer's Office
Paul Doughty	International Association of Firefighters
Mayor Allan Fung	City of Cranston
Dennis Hoyle	Office of the Auditor General
Bruce Keiser	Town of Jamestown[1]
J. Michael Lenihan	Former State Legislator
Richard Licht	Department of Administration[2]
Antonio Pires	Former State Legislator
Mayor Joseph Polisena	Town of Johnston
John Simmons	RI Public Expenditure Council
Steven St. Pierre	Bristol Police Department
Mayor Angel Taveras	City of Providence

[1] Retired September 2013, vacancy not replaced
[2] Member until August 2014, replaced by Steven Hartford, Director of Administration

Executive Summary

The Commission was established to review existing legislation and pension plan administrative practices and to make recommendations for the improved security and funding of locally-administered pension and other post-retirement benefit obligation plans of municipal entities. The composition of the 14-member commission was designed to bring forward the varying views of the stakeholders involved. As a commission, we believed it was vitally important to fully understand the problem, making the investment of our time to talk to professionals in the actuarial, administrative and legal fields, active and retired plan participants and the governing bodies of local plans. The nature of our analysis was to create awareness of the problem, its magnitude, and foster discussion.

Because the retirement security act required Funding Improvement Plans (FIP), we proactively developed guidelines and templates for the municipalities to use in submitting FIPs. Funding Improvement Plan Guidelines are shown in the appendix. The guidelines provided the Commission with consistent information to begin its comprehensive review of existing practices and help us understand what local plans were doing to move out of critical status.

When the Commission began meeting they looked at local plans in critical status. Critical status means a funded ratio of 60% or less. What makes a funded ratio important? Simply put, it is a measure of assets available to pay benefits. Today, there are 22 plans in critical status. This is a dynamic landscape. East Providence and North Providence emerged from critical status with the receipt of the much-publicized Google funds. The Narragansett Town Employee Plan, the West Warwick Town Employees Plan, and the Woonsocket Police and Fire Plan entered critical status when their new actuarial reports were released to us.

The Commission has met 39 times and together we have logged approximately 1000 hours of meeting time. These numbers don't begin to estimate the time and effort the commission members spent traveling to meetings and reviewing hundreds of pages of support materials to prepare for these meetings. The materials have been complex and the commission members approached this work with care and consideration.

We collected data necessary for objective analysis. We started with a range of knowledge and backgrounds among the members and worked as a team to develop the recommendations contained in this report. We initiated meetings that were aimed at developing actuarial literacy for the commission as well as citizens and groups interested in our work. We have developed a lengthy public record and source of information for policy makers. We have taken the results and made interpretations based upon best practices and objective criteria.

We learned that local plans are varied. Some plans are closed, with no new employees entering the plan. Membership is diverse. Only 12 out of the 34 plans studied remain out of critical status. We believe that the Commission's work over the last two and half years has been crucial to illuminating the issue and developing a path for municipalities to exit critical status. Does a "one-size-fits-all" approach work? The answer was a resounding no to a one-size-fits-all approach even as it became clear that oversight was a necessary component in restoring vitality to plans in critical status.

We have kept abreast of significant changes in the reporting requirements for government pension and OPEB plans. These changes are expected to have significant effects on liabilities, financial statement disclosure and are the subject of much scrutiny by rating agencies.

As part of our review we looked to neighboring Massachusetts and the structure of its Public Employee Retirement Administration Commission (PERAC). This entity, which oversees local plans in Massachusetts, is a seven member board with appointments from the governor and state auditor. Our many discussions revealed that the Commission was not in favor of centralized oversight like PERAC, particularly in terms of plan administration and approval authority. See appendix for PERAC structure.

The meetings held over almost three years have provided us a breath of experience which has helped shape our recommendations—recommendations that we have considered in a deliberate and circumspect manner. We transmit them to you with our hope that they are a basis for positive change for local plans and forward movement building upon the existing retirement security act.

Further to this point, each member of the Commission was asked to provide input so that the report would fairly balance dissenting opinions. The Commission considered dissenting opinions no less valuable than opinions where agreement was reached and each commission member was invited to add additional comments for the dissenting opinion. Every effort has been made to provide a balanced perspective.

The Crisis

A brief background on the origin of the Commission is important to understanding the process and recommendations we make in this report. In August of 2011, the City of Central Falls filed for bankruptcy. It gained attention in the national news and provided the sobering cautionary tale as to what could happen to public employees in plans with large unfunded pension liabilities. In November of that same year, the Rhode Island House and the Senate voted in support of the Retirement Security Act. The legislation was signed by Governor Chafee on November 18, 2011.

The legislation aimed to ensure the sustainability of the state's public retirement system. While the reforms of 2011 directly impacted the state-administered Municipal Employees Retirement System (MERS), they did not directly extend to locally-administered municipal pension plans. At this point there were 34 locally-administered plans in 24 communities, of which half cover public safety employees. While many of these plans were also underfunded, their independence and the fact that they are affected by various separate collective bargaining agreements made it difficult to include them comprehensively in the 2011 reforms. In other words, the local community is entirely responsible for administering and funding these plans.

The legislation set the stage for additional review of locally-administered plans by establishing this commission and requiring local plans to complete an initial actuarial valuation and experience study by April 1, 2012. For each plan year thereafter, an annual valuation report must be submitted, as well as an experience study no less than every three years. It required specific actions for plans that have funded ratios of less than 60 percent, including notice to all participants and beneficiaries as well as requiring funding improvement plans.

Many positive steps have been taken by municipalities to address pension and OPEB liabilities. However, pension and OPEB funding issues continue to exist on the local level. The problems are in some instances both severe and urgent, and continued oversight and work with the municipalities is needed to ensure both fiscal stability for the municipalities, and pension and healthcare security for municipal employees and retirees. While many communities are addressing local pension plan issues, the OPEB liability for most communities continues to remain largely unfunded. Only twelve municipalities have begun setting aside funds indicating that there is a continuing need to monitor both unfunded liabilities.

Our Challenge

The Commission engaged in a frank discourse over how much guidance is necessary, welcomed or expected by municipalities. The overarching outcome of our recommendations is to provide security and stability for municipalities, retirees, and citizens. Awareness and education is not a compelling enough outcome for Commission. The Commission is, by statute, charged with making recommendations to the General Assembly.

> *"The Commission shall 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."*
> *(RIGL §45-65)*

Many discussions took place related to developing tools and changes to legislation that municipalities could use to improve the funded status of their local plans(s). Some ideas were recommended, others not, and some were deemed to require further study regarding implications which could interfere in the collective bargaining process. For example, one idea was to introduce enabling legislation allowing for actions on those plans in critical status to make changes to COLAs or other relief from existing municipal collective bargaining agreements. The intent with such enabling legislation would be to provide municipalities with a tool to address the benefit side of the pension equation.

Guiding Principles

The Commission recommends the future form of oversight be guided by the following principles, and all decisions from the oversight body should reflect these principles:

- Foremost, the need for sustainable government
- A commitment to intergenerational equity (by recognizing promises to retired employees and not shifting costs to future generations) balanced with cost control
- Consideration of the need for competitive retirement benefits balanced with the prudent use of taxpayer dollars (for municipal services, education, maintenance of credit ratings)
- Activities, deliberations and determinations are transparent and respect the public trust
- Funding policies and related methodologies adopted by the locally-administered pension plans and accounting for OPEB liabilities are consistent with sound financial, accounting, and actuarial principles

When the Commission's recommendations are considered and action is taken, the Commission believes that the best outcome would be consistent with these principles. And, as a new oversight board is developed, the Commission would hope that a new board strives to be guided by principles that leave room for responsible people to develop practical solutions—solutions which allow for the independence desired by locally-administered plans while offering security to plan participants and accountability to all stakeholders.

In retrospect, these principles enabled the Commission to engage in respectful, spirited discussions which form the basis for this document. Members of the Commission devoted a considerable amount of time providing their honest expression of opinion for the benefit of local plan participants. Even in moments of spirited discussion or disagreement, there has always been a tone of respect and courtesy throughout the proceedings.

Strategies and Accomplishments

Raising awareness and increasing access to information

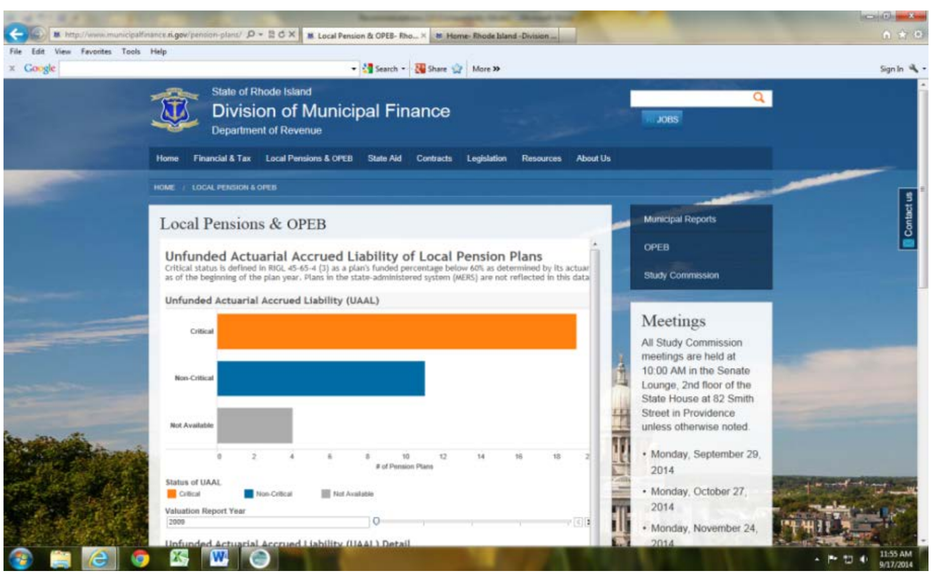
It was important to ensure that stakeholders were aware of the extensive data collected by the Commission and the importance of this information for effective decision-making. This was fundamental to our process. Commission members at one time or another all voiced the sentiment that it is important to have current, relevant data to make informed decisions. The Commission has included an appendix, divided into three parts—part one is supplementary information included specifically for reference to the recommendations; part two includes general pension information such as our recent outreach to all critical status plans highlighting FIP implementation progress and ARC payments planned, paid, and budgeted; part three contains information related to OPEB such as survey results and an important analysis of data based on OPEB valuation reports received through November 2014.

The Division of Municipal Finance (DMF) in the Department of Revenue collects and displays all local municipal pension plan information on its website and continues to work directly with municipalities in training and education on the latest policies effecting pension and post-employment benefits, in conjunction with the Auditor General's Office. The Department of Revenue staff is always interested in making the data more understandable, meaningful and accessible.

We surveyed municipalities on pension related issues, such as governance structure, plan documents and fiduciary responsibilities. A summary of the survey can be found in the appendix, part II. The importance of transparency cannot be overemphasized. During the course of our meetings many commission members have expressed the necessity to "shine a bright light" on the pension and OPEB issues. To that effect, we also surveyed municipalities on OPEB related issues. The responses to the OPEB survey can be found in the appendix, part III. We provided education on pension terminology, and methods and changes in GASB standards which was essential for commission members and other stakeholders. See the glossary in the appendix, part I.

Commission meetings were televised. In addition to televised meetings, recorded videotaping of each meeting was made by Capitol TV so that stakeholders can view meetings at any time. The link is http://www.rilin.state.ri.us/CapTV/pages/vod.aspx

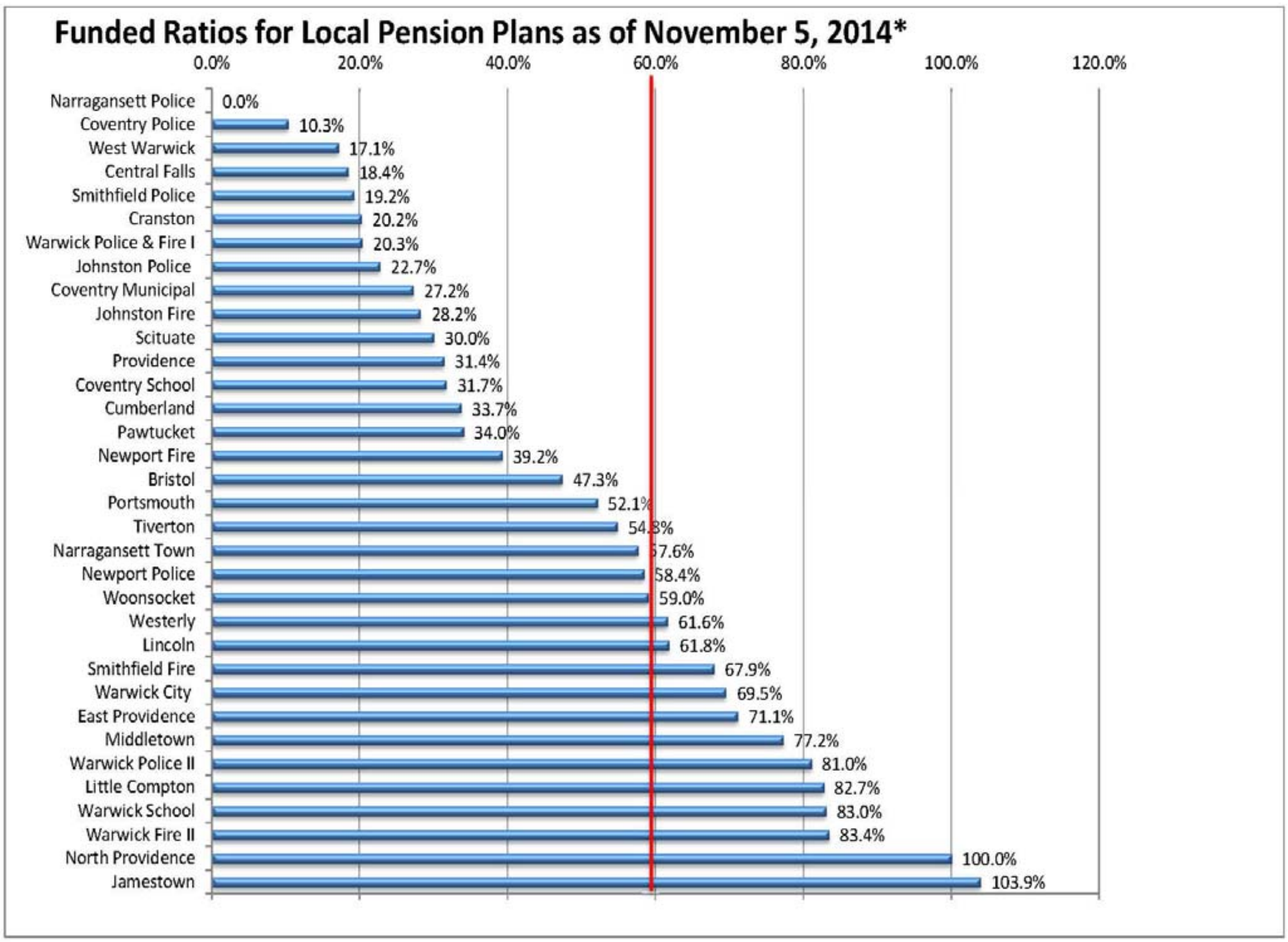
Accurate and detailed minutes of all commission meeting are available on the DMF website. The Division of Municipal Finance has an entire section devoted to pension and OPEB valuations, experience studies and funding improvement plans. DMF assisted the Commission to make it easy for stakeholders—mayors, managers, active and retired plan participants, and policymakers to name a few—to access information easily.



Transparency is vital: On March 6th the Department of Revenue, Division of Municipal Finance launched visualized pension and OPEB data on its site to assist stakeholders not just in accessing information on local plans, but also in understanding this collection of data.

Developing shared goals

Our relationship with municipalities was a vital means of collecting information. Funding improvement plans (FIPs) were required by statute. To encourage consistency from all communities, the Commission developed guidelines, shown in the appendix, part II. With assistance from the Commission's actuary, a series of public meetings was held over the course of three months where municipalities presented their funding improvement plans before the Commission. With few exceptions, the original FIPs, if implemented, would bring plans out of critical status by 2033. It should be noted that due to the low funding levels, progress in the early years is marginal. As shown below, a graphical representation of plans in critical status based upon the most recent valuations available to the Commission reveals that 22 plans are under 60% funded. The unfunded liability for all locally-administered plans together is more than $2 billion. Also included in the appendix is a more recent update on the progress of implementation in the form a narrative. Bear in mind that pension and OPEB information constantly requires updating and will be accurate as of the date shown on the exhibit. Many original FIPs required negotiation with employees and in some cases retirees, and therefore final FIPs may yield different results.



* Funded ratios are based on the most recent valuation reports available to the Division of Municipal Finance as of this date.

Ultimately we hope that each municipality has viewed us as partners in the process of developing better financial health for pension and post-employment benefits. We need to ensure that the proposed oversight body facilitates greater interaction, understands the needs of all stakeholders and evaluates data presented using best practices and a public disclosure process.

Delivering training

We developed resources and materials, both online and in hardcopy, to support data contained in actuarial reports received. The Division of Municipal Finance and the Office of the Auditor General conducted training for municipalities to highlight complex Government Accounting Standards Board (GASB) reporting requirements and continues to do so. See appendix for a copy of the jointly issued **Muni**-*news*.

Developing training and recommendations to improve local pension plan health and achieving improvement in funded ratios is not an easy task. Promoting an increase in the knowledge base and changes in behavior towards best practices relies on regular interaction with municipalities.

Finding

The Locally-Administered Pension and OPEB Study Commission finds that there is a strong need for continued oversight of local pension and OPEB plans. This need is demonstrated by the review process undertaken by the Commission and the ongoing nature of the material reviewed by the Commission and support staff, including valuation reports, experience studies, funding improvement plans, testimony related to actual implementation of improvement plans and responses to survey questions. Each year, new valuation reports are received by the DMF in the Department of Revenue and the Office of the Auditor General and as this occurs, the picture changes relative to plan assets, liabilities, unfunded accrued actuarial liability and the plans funded ratio. Some local plans have declining funded ratios and although not yet falling under the statutory definition of critical status, these communities may need additional guidance.

New accounting and financial reporting guidance will soon require that governmental employers recognize the net pension obligation for its employees participating in defined benefit plans. In most instances, this will be a significant liability newly reflected on local government balance sheets. While this information was largely disclosed in previous government financial statements, the new changes will require that the full amount "owed" for pension liabilities be recognized in a highly visible way thereby increasing focus and attention, particularly when plans are poorly funded.

Similar accounting and financial reporting changes are proposed (but not officially issued) for OPEB plans, which will have a further dramatic effect on governmental financial statements. Few OPEB plans are currently well funded since many have only recently begun to contribute on an actuarially determined basis. Having an oversight body vested with monitoring OPEB plans and exploring options that could ultimately promote efficiency and reduced costs is therefore both timely and necessary.

Recommendations Considered

The Commission has considered eleven recommendations to improve local pension and OPEB plan health and help municipalities meet the challenge that will ensure sustainable benefits that are also affordable and competitive. We've taken great effort to incorporate dissenting viewpoints in this document so that legislators can fully and objectively assess alternatives.

1. Establish an oversight board
2. Expand legislation requiring fiscal impact statements
3. Require an annual funding notice
4. Expand proposed budget language in municipal disclosure process
5. Continue funding municipal incentive aid program
6. Study feasibility of administering a voluntary program to invest plan assets
7. Consider expanding criteria for oversight under the fiscal stability act
8. Develop a voluntary MERS pathway
9. Continue to monitor OPEB plans
10. Consider funding improvement plans for OPEB
11. Consider establishing a state-wide OPEB trust

1 | Establish an Oversight Board

The Commission recommends amending RIGL §45-65-8 to replace the study commission with an oversight board charged with the responsibility of overseeing all locally-administered pension plans. The oversight board would not be involved in determining benefits or benefit structure. Its responsibility would be to ensure that regulations are developed through a public hearing process and that local plans follow the best practices of actuaries and government financial standards.

Membership of the Oversight Board. There was considerable discussion about the membership composition of the board. After consideration of the organization structure of the Pension Study Commission and of other area oversight bodies, the Commission proposed that a balanced oversight body may be composed of the following categories of stakeholders: local elected officials/town managers, labor, state officials and independent public members as follows:

- Local mayors, managers, or town administrators (representing elected and appointed positions)
- Police, fire and municipal representatives – with both active and retiree representation
- School department and teacher representation (considered especially important to the OPEB issues)
- League of Cities & Towns member or designee
- Director of revenue or designee
- Director of administration or designee
- Auditor general or designee
- General treasurer or designee

- Independent public members with expertise in finance, investments, accounting or actuarial expertise

The current statute provides for the following composition of the Pension & OPEB Study Commission: Fourteen (14) members: the director of the department of revenue, or his or her designee; who shall be the chair, the auditor general, one member each representing the department of administration, the general treasurer, the League of Cities and Towns and the Rhode Island Public Expenditures Council, and three (3) members appointed by the governor representing municipal police, fire and non-public safety employees. In addition, the Speaker of the House and President of the State Senate shall each appoint one member to the commission and then shall jointly select and appoint one elected mayor from a city or town with a population greater than 50,000, one elected mayor from a city or town with a population less than 50,000 and one appointed town administrator.

Commissioners expressed the concern that any proposed board that was not balanced in representation may dictate to the municipalities and/or labor without consideration of the interests of these groups. The commission members were conflicted in determining the composition of a group of impartial oversight board members. Mayors and union representatives had concerns about an oversight body without representation from their groups. Some commission members cited a need for representation of active and retired plan members. Other members expressed the concern that impartiality may be difficult for a sitting mayor/ town manager to take a position contrary to another mayor's/town manager's funding improvement plan. The state director of administration was included particularly as the new oversight body begins considering OPEB issues and the possible formation of a state-wide OPEB trust and voluntary MERS pathway.

Clearly, there is a delicate balance between having a board that is large enough to represent all stakeholders and yet small enough to get the job done. Some felt that a large board might be unwieldy and would make it difficult to get even simple matters like a quorum accomplished. Regardless of the size of the board, the principles identified by the Commission and a public process must be adhered to. The public hearing process would be the mechanism for all interested persons or groups to provide testimony, data, and insight into a particular issue being considered by the oversight board.

Any recommendation should be considered in a "form follows function" approach. In other words, once it's been decided what the authority and powers of the board would be, the General Assembly then can develop a body best suited to carry out these functions in an impartial manner. After considerable discussion, the Commission reiterated that a body is needed for oversight and the exact composition should not overshadow the unanimous agreement that an oversight body is necessary.

Authority and Powers of an Oversight Board. The Commission emphasizes that the authority and powers of the Oversight Board are not intended to interfere with the collective bargaining process, or encourage unnecessary involvement in municipal financial affairs. Rather, it is intended to shine a bright light on problems and develop broad solutions using objective criteria of sound actuarial, accounting and financial practices.

For example, one suggestion is to utilize a ranking (red, yellow, green zones) with certain requirements for each ranking. It was suggested that the new oversight body research concepts in order to provide an automatic correction for plans that enter a low funding range. These automatic correction levels would have varying degrees of authority depending on the deviation from accepted actuarial and accounting practices. Any concept in this section should be further developed through the public hearing process and, when necessary, possibly through the legislative process.

These concepts include:

- Develop regulations or procedures that would set the parameters for the work of the Oversight Board. These would be developed through a public hearing process. The oversight body would contact municipal governments and plan participants via plan sponsors, to engage in dialog and written comment on proposals. The public would be encouraged to participate in recommendations through a public comment period or hearing process. Some members of the Commission have concerns that the public hearing process is not enough. For example, it was expressed that without certain representation on the oversight board, a public hearing process would not be sufficient.
- Establish training standards for members of all locally-administered pension boards or investment bodies. This could include minimum continued education requirements for fiduciary training, investments, ethics, and open meetings. This training requirement should be designed to be flexible so that it does not place an undue burden on local pension and investment board volunteer members. For example training could be delivered through video-taped training sessions or webinars.
- Require all local governments with defined benefit pension plans to formally adopt a funding policy, subject to approval by the Oversight Board, which provides for actuarially sound, reasonable assurance that the cost of those benefits will be funded in an equitable and sustainable manner. This is based on the Government Finance Officers Association's (GFOA) best practice guidelines for funding defined benefit pensions.[3] While municipalities follow GASB for accounting purposes, this best practice is a by-product of GASB 67 and 68 changes where there is a de-linking of the accounting guidance from the funding. Since this is a transition period, municipalities will need to bolster their funding policy.

> *"The Government Finance Officers Association (GFOA) recommends that every state and local government that offers defined benefit pensions formally adopt a funding policy that provides reasonable assurance that the cost of those benefits will be funded in an equitable and sustainable manner."*

[3] See appendix for the full GFOA best practice guidelines.

- Adopt guidelines for all locally-administered plans, including those in critical status, and utilize these guidelines to provide a standard for measuring the fiscal health of the plan, improvement in funded status and compliance. While not in statute, the guidelines would provide an objective tool for evaluating a FIP when presented, and monitoring FIP progress.
- Review funding improvement plan submissions for those plans in critical status to determine whether the FIP meets the established guidelines.
- Recommend withholding non-education state aid if:
    a. there are two consecutive years of not paying at least 95% of the actuarially determined contribution for pension plans in each year
    b. increases in benefits which create an increase in the unfunded liability, are granted when the plan is in critical status
    c. failure to take actions required in final FIP or failure to submit a FIP

  This concept was discussed extensively with respect to binding arbitration decisions increasing ARCs and significant market reductions reducing plan assets. It was suggested that non-education aid funds that are withheld be directed back into the pension plan to reduce the unfunded liability.
- Request data from the locally-administered pension plan regarding its investment and asset allocation policy, and actual investments when the plan's investment performance is 200 basis points or more below the MERS investment return for the same comparable two-year period calculated pursuant to GASB 67 guidelines. The Board may also make recommendations or require investment of the pension fund assets by the State Investment Commission when deemed necessary and appropriate after consideration of the investment policies and investment performance of the locally-administered plan.

  While some Commission members questioned whether MERS was the appropriate plan to measure against, the Commission's consulting actuary stated that local plans generally use the state plan as a benchmark. Any wide variation of plan performance (more than 200 basis points) must be viewed in the context of whether or not the plan is closed (where members are retirees only and no active employees entering the plan). These plans should be viewed differently due to asset allocation and stream of income.
- Advocate for sufficient resources to fund the activities of the Division of Municipal Finance in support of the board's responsibilities as part of the annual budget process.
- Power to question and require the plan's actuary to make a presentation on the actuarial assumptions and methodology used in the valuation.
- Ability to refer complaints regarding pension fraud or other matters to the appropriate enforcement body. The process for whom to contact would be outlined by the oversight body in regulation.
- Consider establishing units for actuarial, audit, investment, legal, disability, fraud, information technology and communication services similar to Massachusetts' PERAC agency.
- Review and accept annual report, prepared by the Division of Municipal Finance, and submit report to the governor and general assembly.

- Potential for drafting legislation. One example suggested was enabling legislation allowing for actions on those plans in critical status to make changes to COLAs or other relief from existing municipal collective bargaining agreements. The intent with such enabling legislation would be to provide municipalities with a tool to address the benefit side of the pension equation. This particular concept, in terms of the *specific* example discussed, did not generate consensus. The idea that legislation, in general, might be developed with support from the Commission was agreed upon.

The concepts developed for the authority and powers of the oversight board also met with considerable discussion, particularly as they relate to the withholding of state aid and adoption of a funding policy which must be approved by an oversight body. The auditor general and director of revenue both agreed that some enforcement powers were necessary for steering plans on the path to sustainability. Without enforcement measures there would be slow or little progress other than a process of public shaming. However, as has been stated before, no consensus was reached on withholding state aid.

Whether to require adoption of a formal funding policy addressed what some commission members considered to be an assumption of fiduciary responsibility. It was noted that there is an existing fiduciary responsibility on the part of local plan sponsors to plan participants and that since it was already established it might further be suggested that perhaps the oversight board should consider approving the adopted funding policy.[4]

Other members responded that many of the suggested requirements were over-reaching and gave the state too much control over local issues. Changing certain items to "voluntary" provided some measure of support. One commission member, in expressing his dissent, stated that he had concerns about giving certain powers to an oversight body and that agreement to this recommendation was directly related to the body's composition. The view was that if there was not a well-composed oversight body, he would have a greater concern with the powers and authority given to the oversight body. His concern is that there would be interference in the collective bargaining process and unnecessary involvement in municipal affairs.

The Division of Municipal Finance and Office of Auditor General will provide staff support for this board, including but not limited to:

- Maintain a database of all actuarial valuations which summarizes key information from the valuations.
- Maintain local pension and OPEB valuations and experience studies on the DMF website.
- Collect and analyze municipal data and make recommendations to the oversight body based upon the principles described and best practices.
- Prepare an annual report summarizing the plans in critical status addressing the progress made and compliance with the guidelines.

[4] See appendix for the GFOA best practice which outlines the core elements of a funding policy. Also included is a sample funding policy.

- Provide oversight to ensure FIP implementation is on track.
- Confirm whether FIPs have been approved by the governing body of the municipality.
- Provide ongoing education and training.

2 | Expand Legislation Requiring Fiscal Impact Statement

The Commission discussed amending RIGLs §16-2-21.6, and §45-5-22 related to collective bargaining, and fiscal impact statements by requiring that the impact statement be accompanied by a statement from an actuary, with a cost estimate, for collective bargaining changes *affecting only plan design of pension and OPEB items*, prior to entering into them, if there is a material change. One member pointed out that a definition of materiality should be considered.

This recommendation would ensure that the cost or savings to the municipality or fire district is analyzed with a long-term perspective. Without an actuary's analysis, the currently required fiscal impact statement could significantly underestimate the cost or savings of changes in future pension and OPEB promises which will fall upon future generations.

While there was general consensus on this concept, there was discussion about whether this recommendation represented an unfunded mandate. Some commissioners thought that seed money for the first year of implementation would be appropriate and this should be considered. One member asked that the cost for preparation of this estimate be quantified thinking that it could be expensive and since it would be mandated that cost assistance should be provided to the municipality. Others on the commission stated that municipalities should know the full cost for benefits prior to adopting any change as this recommendation is a good management practice. It was suggested that we quantify the cost of preparing an impact statement. One commission member emphasized that we should not undervalue the utility of this recommendation even though there was some debate as to the cost. He noted the Commission's extensive progress made by working collaboratively on issues such as this one. Another commission member thought that this should not be mandatory, but could be a recommended best practice.

Dan Sherman, the commission's actuary, stated that preparing such a statement would not necessarily be a huge cost and the actuary can help in this process.[5] State law requires an actuarial valuation be prepared prior to action on any changes to state-administered pensions.

[5] The cost of an actuarial study would be dependent on the nature of the change(s), the size of the group and the complexity of the plan. For example, estimating the cost for going from Final 5 year average to Final 4 year average, would take about an hour of actuarial work costing approximately $1000. If the request was to change the eligibility for a vested termination benefit from 7 years to 6, an actuary might say "insignificant" and not send a bill.

3 | Require an Annual Funding Notice

One of the commonly stated concerns from plan members, especially those who are making concessions as part of a Funding Improvement Plan, is lack of trust of the plan sponsor to make the annual funding payments and invest the funds prudently. It is important that each stakeholder feels that the information relating to their pension plan is transparent and available to them on a regular basis. The 2011 Retirement Security Act provided that letters be sent to members and other stakeholders if the plan was in critical status. Ongoing communication to plan members is important for all local plans, and is a best practice adopted by the private sector.

The Commission recommends requiring that an annual statement be filed each year by any local plan, to the oversight commission, the governing body, the participants and beneficiaries of the plan, in a format to be determined by the Division of Municipal Finance, which summarizes key information in the valuation report and how to obtain a copy of the report. This Annual Funding Notice would include important information about the funding status of the pension plan. All locally-administered pension plans would provide this notice every year regardless of their funded status. This notice is provided for informational purposes. A sample Annual Funding Notice can be found in the Appendix.

One commission member considered this concept a great comfort to members knowing that there is a public notice requirement. This concept meets the principle of openness and transparency. One municipality is already doing a notice along these lines whereby it is the municipality's requirement to provide notification to all plan participants if the actuarially determined contribution is funded at less than 95%.

Other members felt questions regarding cost need to be considered—actuary and municipal staff time along with postage. It was pointed out that the notice could be delivered to retirees with their paper check and therefore there would be no additional cost to implement this recommendation by mail. The information can generally be completed by the municipal finance director with brief assistance from the actuary. The Treasurer's office weighed in with the observation that the Employee Retirement Income Security Act (ERISA) requires that changes implemented which do not follow the actuary's recommendation require that a notice be sent to all participants. Also, there would need to be information or language stating it is the responsibility of the member, whether active employee or retiree, to inform the plan of any change in contact information or change of address. It was suggested that this be part of both the template and proposed legislation. Alternatively, it was also suggested that the wording in the notice remain flexible in order for municipalities to adjust to their needs. Municipalities should be allowed to disseminate in various ways (i.e. website). One member stated that it is important to ensure that this information would not open up municipalities to any liability issues.

In the City of Pawtucket, the annual funding notice requirement is already required by local ordinance by providing for notice to active and retirees if the funding is budgeted at less than 95% of the actuarially determined contribution. There was general consensus that this recommendation would encourage future municipal leaders to be transparent and continue the work started by the Commission.

Addressing the cost issue, it was noted that MERS notifications sent to its members are part of the administrative cost spread across all the plans. It would be advisable for local plans to discuss this with their advisors before including in administrative costs.

4 | Expand Proposed Budget Language in Municipal Disclosure Process

It is recommended that RIGL §44-35-7 be amended to include language indicating the budgeted actuarially determined contribution (ADC) for locally-administered pension plans (if applicable) for the proposed budget year, the percentage contributed for that year, and the funded ratio based on the most recent actuarial valuation. A draft of language for the change in statute is provided in the Appendix.

There was general consensus that this recommendation was an easy addition to an already required public notice.

5 | Continue Funding Municipal Incentive Aid Program

Recommend continued funding through the Municipal Incentive Aid program for municipalities if criteria according to the statute are met. In addition, the following amendments were recommended by the Commission:

- Amend the statute for municipal incentive aid: if a municipality is not eligible to receive the aid in FY 2014, the respective amount would be re-appropriated into the following fiscal year, at which time the amount re-appropriated would be distributed to the municipality provided that the municipality has satisfied the eligibility requirements for the prior fiscal year and the current fiscal year. This recognizes that the timing for meeting the guidelines for some municipalities will not impose an unintended punitive effect.
- Amend the statute so that the Required Funding Contribution only applies to municipalities that have a funded ratio below 100%. The statute requires that pension plans that are not in critical status fully fund the Required Funding Contribution in order to receive the incentive aid.

It should be noted that the bullet points in this recommendation have been addressed in the budget passed by the General Assembly during the 2014 session.

6 | Study feasibility of Administering a Voluntary Program to Invest Plan Assets

The Commission recommends further study to determine whether the State Investment Commission could administer a program which invests assets of locally-administered pension plans or OPEB trusts on a voluntary basis.

The members of the Commission were somewhat in agreement provided that the language was changed to reflect this as a voluntary program. Others stated that reduced risk, lower fees, diversification of assets, professional management and efficiencies related to economies of scale made this a very worthwhile recommendation. Additional work would need to be provided by the Treasurer's Office. Ultimately, the Commission agreed that further study is necessary to implement this program. The Commission discussed having the consulting actuary, Dan Sherman, provide assistance in developing a model program similar to Massachusetts.

7 | Consider Expanding Criteria for Oversight under the Fiscal Stability Act

The Commission did not reach consensus on whether to include language that the "critical status" of a locally-administered pension plan would be considered as one of the criteria under the provisions of the Fiscal Stability Act. Under current law, if a municipality or fire district meets two out of five criteria, as specified in the statute, that municipality or fire district may be subject to state oversight. The criteria under RIGL §45-9-3 are:

- The city, town, or fire district projects a deficit in the municipal budget or fire district budget in the current fiscal year and again in the upcoming fiscal year;
- The city, town, or fire district has not filed its required audits with the auditor general by the deadlines required by law for two (2) successive fiscal years (not including extensions authorized by the auditor general);
- The city, town, or fire district has been downgraded by one of the nationally recognized statistical rating organizations;
- The city, town, or fire district is otherwise unable to obtain access to credit markets or obtain financing when necessary on reasonable terms in the sole judgment of the director of revenue;
- The city, town, or fire district does not promptly respond to requests made by the director of revenue, or the auditor general, or the chairpersons of the house and/or senate finance committees, for financial information and operating data necessary to assess the fiscal condition of the city, town, or fire district in the sole judgment of the director of revenue.

It was discussed that critical status be added as an additional event so that there would be two out of six items which might trigger state oversight or perhaps three out of six. This idea, supported by some commission members, is meant as additional criteria for consideration purposes only, perhaps preventing some of the dire situations experienced in other communities. It is a means of additional measurement and is not intended to imply that a municipality with a local plan already in critical status would automatically be placed under oversight. In fact, the Commission Chair stated that the state has not necessarily intervened when a municipality or fire district has met two of the five statutory criteria. The department of revenue will conduct additional analysis first indicating that this is one more measurement tool to access fiscal stability. An additional reason suggested was that there are examples of municipalities who have had surpluses only because they have not been paying the plan's ARC. In other words, it might be possible to by-pass the existing criteria by not funding the ARC. Another commission member noted that it may take a rating agency some time to pick up on an issue and until a rating downgrade occurs the entire financial picture would not be clearly depicted. The Commission discussed including language that as long as a municipality is "on the pathway" towards an increased funding level and following the funding improvement plan (FIP) this would not be a criteria. In other words, it remains neutral if a community is following its FIP. As a point of clarification, expanded criteria would not automatically trigger state oversight.

Commission members remain divided on this recommendation, with one member indicating strong dissent because the recommendation did not specifically address funding and stability of the local plans, but rather was strengthening another statute. It was considered over-reaching of the Commission's power and authority to add more reach to an already powerful statute. The commission member stated that this addition to the statute "increases the potential for it to be exploited and places municipalities at an unnecessary risk" in addition to the belief that it was an unnecessary recommendation. It was emphasized that the statute would work against measures already enacted by the General Assembly and exposes municipalities to what was felt as unnecessary oversight.

8 | Develop a Voluntary MERS Pathway

Create a voluntary and optional pathway to MERS that interested communities can follow:

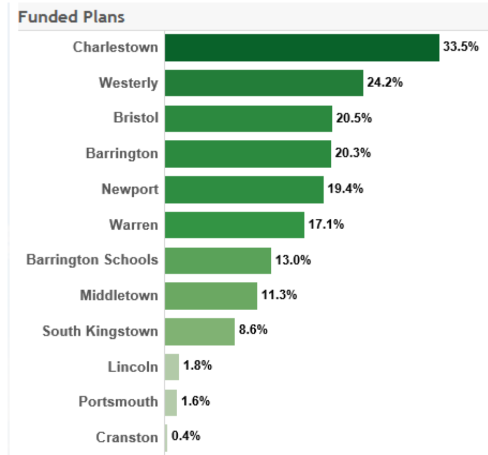
- Consider providing one-time incentives
- Provide specific period to reach benchmark funding requirements
- Allow for re-amortization of recalculated unfunded liability
- Allow members to retain existing service credits
- Include additional protection for existing MERS plans and members by developing entrance agreements which address a local plan's responsibility to fund the actuarially determined contribution and the consequences for failure to make the required funding contribution. This would ensure that a local plan's funding has the same priority as a MERS plan. This is particularly important for a poorly funded closed plan.

The Commission was not opposed to this recommendation provided that it remains a voluntary and optional pathway.

Benefits to local plans joining MERS include the ARC payment requirement, minimized investment risk, and the investment return potentially optimized by participation in a professionally managed and diversified portfolio. Further, there would be economies of scale derived from reduced investment expense and actuarial costs (costs are spread over a larger portfolio), the elimination of local administration duties and elimination of the local disability determination process.

It should be noted that closed plans present a particular challenge. Commission members recommended further study as this is conceptually agreeable but needs to be cautiously developed. This would be especially important with regard to closed plans. Most commissioners expressed the idea that a mandatory recommendation to move plans into MERS would not work and some expressed very strong opposition to anything mandatory.

9 | Continue to Monitor OPEB Plans



The Commission considered regular submission of OPEB valuations, similar to the requirements for pension valuations, to the Auditor General and Division of Municipal Finance. The submissions would follow GASB requirements, generally biennially for plans with a total membership of 200 or more, triennially for plans with less than 200 total members.

We studied the 52 locally-administered public plan sponsors in Rhode Island (including 39 cities and towns, nine separate school valuations, and four regional school districts). Most were found to provide some level of OPEB at the end of FY 2012. At this time we have not included fire districts, water and sewer authorities and housing authorities. The total OPEB liability for Rhode Island's cities, towns and regional school districts is $3.1 billion based on the most recent valuations received. This liability is funded at 1.4%, resulting in a net unfunded liability of $3.0 billion.

It was also clear from our study that actuarial data lags behind fiscal year reporting. In FY 2012 financial statements, 19 of the 52 plan sponsors had 2012 valuation reports (37%). The number of plan sponsors that have begun prefunding the OPEB liability is 14, or 27%, of the 52 plan sponsors studied. Seventy three percent of local OPEB plan sponsors have not set aside money to pay future benefits. On a national level, many consider this unfunded liability perhaps more critical than pension issues due to the varied nature of the bundle of benefits provided in a plan.

The Commission agreed that continued monitoring of OPEB plans would be valuable.

10 | Consider Funding Improvement Plans for OPEB

The Commission discussed whether to recommend that a funding improvement plan for OPEB, similar to the FIP for pensions, be required. There was no consensus on this although all commission members agreed that this is a substantial liability that will need to be addressed in some way. The Commission recognizes that guidelines would need a different approach due to the magnitude of the issue. Again, the total OPEB liability for Rhode Island's cities, towns, and regional school districts is over $3 billion based on the most recent valuations received with funding at less than 2%.

11 | Consider Establishing a State-wide OPEB Trust

The Commission discussed whether to recommend establishing a state-wide OPEB trust to maximize efficiencies and investments for local plans. The Commission considered it important noting that most plans are paying for benefits on a pay-as-you-go basis and the liabilities are substantial (over $3 billion for 52 plans studied). Collectively, assets totaling approximately 1% of liabilities have been set aside for the payment of future benefits. A trust could be created by the State similar to the Municipal Employees Retirement System (MERS) agent multi-employer plan or as a collaborative of cities and towns administered by the RI Interlocal Trust. This structure allows for separate accounting whereby one plan's assets are not used to pay for another plan's liabilities.

Both could be established to administer benefits and/or pooling of investments. The pooled investments would maximize returns and help to reduce risk. Again, economies of scale would bring benefits to small plans and reduce inefficiencies in the existing approach. Commission members acknowledged that administering benefits would be burdensome. The Commission recommended further study before a state-wide trust is established. This may even be an extension of the concept of shared or pooled services. Some commission members felt that specifying a minimum number of municipalities volunteering to participate was necessary in order to create the structure.

Conclusion

The Commission is hopeful that these recommendations and comments will provide a strong foundation for the General Assembly to make informed decisions and adopt legislation that embodies the principles we as a commission have utilized in our deliberations.

The Commission is grateful to Dan Sherman, of Sherman Actuarial Services, LLC who serves as consulting actuary to our group. Dan's expert testimony was always clear, understandable and based upon sound practice. We were also fortunate to have other actuaries address us—Joe Newton from Gabriel Roeder Smith (GRS), Becky Sielman from Milliman, and David Ward from Angell Pension Group. We thank Frank Karpinski Executive Director from the State of Rhode Island Retirement System who explained MERS to us and Joe Connarton from the Massachusetts Public Employees Retirement System who explained local plan oversight in our neighboring state. The Commission greatly appreciates their assistance to us.

The Commission recognizes the ongoing support Rhode Island municipalities need to begin to effectively manage the substantial liabilities present in local pension and OPEB plans and put these plans on a path toward fiscal sustainability. While we have achieved our goal of presenting recommendations to the General Assembly, the Commission recognizes that there is an ongoing yearly flow of actuarial data to collect and analyze, as well as continuous monitoring required so that the long-term health of local pension and OPEB benefits is clear and achievable.

Appendix

Part I – Supplementary Information for Recommendations
Part II – General Pension Related Information
Part III – OPEB Related Information