PENSION COSTS

September 14, 2011

House Finance Committee

Senate Finance Committee

WHY ARE WE HERE?

- State is facing growing pension bill
- General Treasurer has focused on the problem, its magnitude and implications
  - Convened a working group to offer input on possible solutions
  - In conjunction with the Governor, will offer legislation for the Assembly to consider

WHY ARE WE HERE?

In advance of that consideration, the Assembly is taking steps to ensure its members have all the information it needs

- Last week's event for all members
- Briefings for both chambers from the General Treasurer
- Finance Committee meetings

WHY DOES IT MATTER?

- Current projections have pension costs consuming larger proportion of resources
- State struggling to emerge from most recent economic downturn
- Still facing structural deficits in five-year forecast
  - No near term projection to grow our way out of the problem

PENSION COSTS

Focus on how pension costs are calculated and key drivers of those costs

- Review current state plans
  - Plan design and demographics
  - Current and historical financial positions
  - Most recent pension changes and retirement board actions
- Retiree Health Basics

PENSION COSTS: KEY TERMS

- **Defined Benefit (DB) Plan –** provides guaranteed benefit that takes into account compensation, years of service and age
- **Actuarial Assumptions –** factors used in estimating cost of funding a DB plan; includes investment rate of return, mortality rates, termination rates, etc.
- **Unfunded Actuarial Accrued Liability –** present value of benefits earned to date not covered by current plan assets
- **Funded Ratio** – ratio of the actuarial value of assets to the actuarial accrued liability

PENSION COSTS: KEY TERMS

- **Annual Required Contribution (ARC) –** employer's required contribution that consists of the normal cost and the amortization payment
- **Amortization Payment –** portion of the ARC that is designed to pay interest on and to amortize the unfunded liability
- **Normal Cost –** portion of the cost of projected benefits allocated to the current plan year

Handout includes comprehensive list

RETIREMENT

- Rhode Island has a defined benefit plan
  - State employees, public school teachers
- Participation in the plan is mandatory for all except certain Higher Ed. employees
  - Defined contribution plan
  - State makes 9% payment into a 401K type plan

RETIREMENT – CURRENT PLAN: TEACHERS AND STATE EMPLOYEES

- Age 62 minimum
- Salary basis is five highest consecutive years
- Limits COLA to first $35,000 of a pension, indexed to inflation but capped at 3% beginning on later of 3rd anniversary of retirement or age 65
- Most retirees and many current employees qualify for greater benefits that had been in place before recent changes

RETIREMENT SYSTEM - DEMOGRAPHICS

Active Members	State Employees	Teachers
Plan A (vested prior to 07-01-05)	4,870	4,837
Plan B	6,252	8,693
Total Active	**11,122**	**13,530**
Vested	6,471	8,260
Average Age	48.6	44.9
Average Service	13.8 Years	12.9 years

RETIREMENT SYSTEM - DEMOGRAPHICS

Retirees	State Employees	Teachers
Service Retirees	9,500	9,448
Average Annual Benefit	$25,887	$41,735
Disabled Retirees	753	286
Average Annual Benefit	$19,265	$27,643
Beneficiaries and Spouses	1,168	479
Average Annual Benefit	$16,393	$22,837
Total Retirees & Beneficiaries	**11,421**	**10,213**

RETIREMENT SYSTEM DEMOGRAPHICS

Active Members	Judges	State Police
All	49	211
Vested	10	5
Average Age	58.8	39.5
Average Service	10.2 Years	11.5 years
Applies to those hired after: *(all others funded pay-go)*	January 1, 1990	July 1, 1987

RETIREMENT SYSTEM - DEMOGRAPHICS

Retirees	Judges	State Police
Service Retirees	6	1
Average Annual Benefit	$133,831	$79,779
Disabled Retirees	0	3
Average Annual Benefit	NA	$58,075
Beneficiaries and Spouses	4	0
Average Annual Benefit	$59,914	NA
Total Retirees & Beneficiaries	**10**	**4**

WHO DECIDES WHAT?

- General Laws – Title 36
  - Classification
  - Retirement Benefits, Employee Contribution
  - Retiree Health Benefit
- General Laws – Titles 9,16, 42,45 (Teachers, Judges, State Police, MERS)

WHO DECIDES WHAT?

- Collective Bargaining Process
  - Cost of living adjustments
  - Longevity Increases, excluding education unions (Pre-FY 2012)
  - Medical benefit contributions
  - Employee co-shares
  - Layoffs and leave time

RECENT PENSION CHANGES

- Several rounds of recent changes to pension and retiree health benefits
- Largely driven by budget pressures in response to growing costs
- Pension changes initially targeted to new and non-vested employees
  - Eventually extended to those already vested but not yet eligible to retire

RETIREE HEALTH AND PENSIONS: TIMELINE OF RECENT CHANGES

- *2005* – Initial round of pension benefit reductions, creation of a Plan B
- *2008* – Reductions to retiree health benefits to lower costs and move to actuarial system
- *2009* – Further pension benefit reductions affecting even those vested
- *2010* – Additional reduction to pension COLA

PENSIONS – ISSUES

- Asset losses = single largest reason for declining funding ratios
- Investment earnings not meeting actuarial expectations
- Currently assumes 7.5% investment return; it had been 8.0% through 1997 and 8.25% through 2011
- Board voted twice in the mid 1990's to "mark to market" to keep contribution rates low

PENSIONS – ISSUES

- Other major impact = demographic assumptions
- System incurred higher costs than actuaries assumed
  - Retirees were retiring earlier, living longer
  - Employee salary growth larger than anticipated in assumptions used to calculate costs

PENSIONS – ISSUES

- Funded status result of:
  - Contribution levels
  - Benefit policy / benefit growth
  - Asset returns
  - Updated experience studies

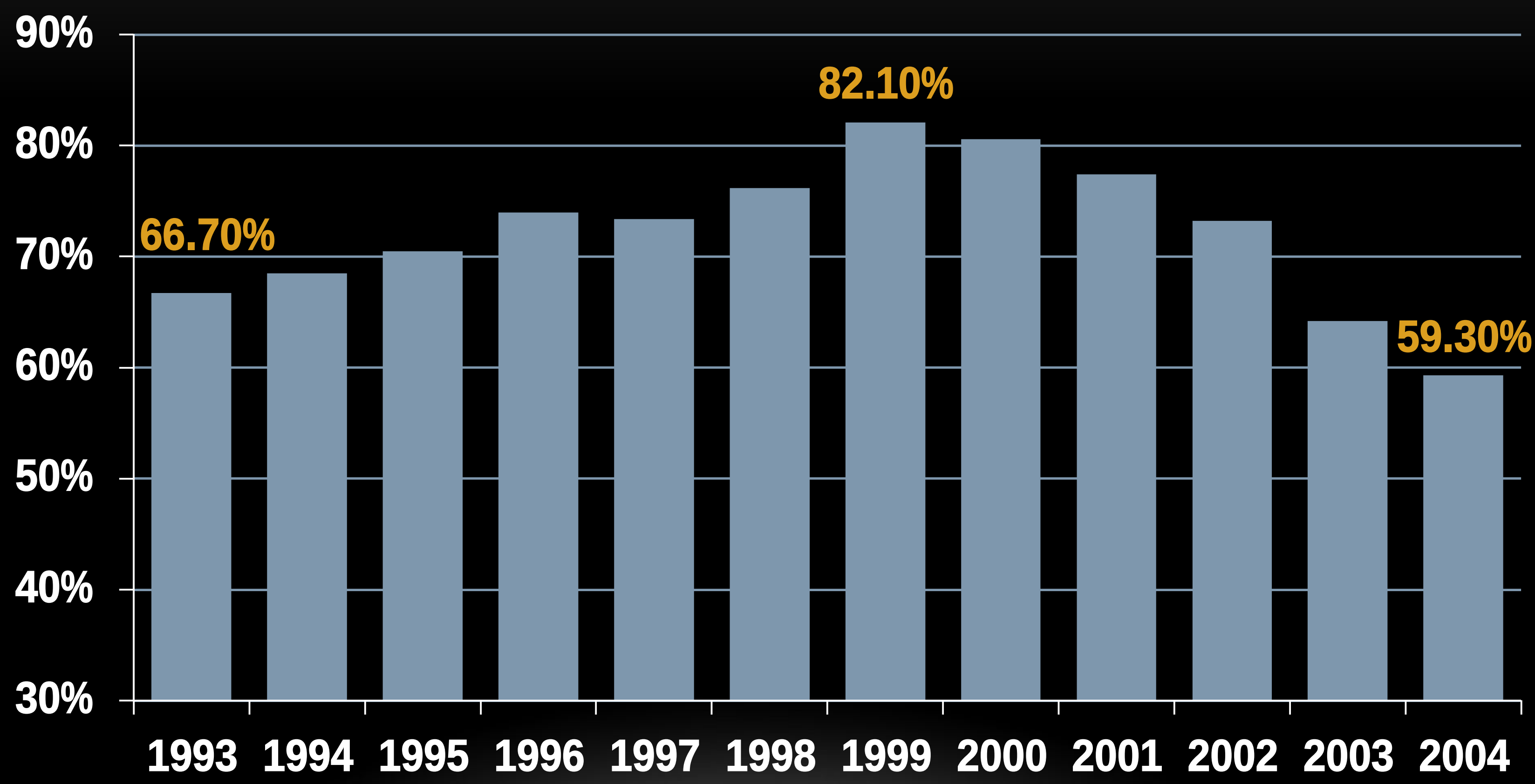
PENSIONS – ISSUES

- Increases in benefits during 1970s and 1980s
- No major changes in benefits between 1992 and 2004 but costs rose and funded status declined
- Rhode Island among the lower funded

PENSIONS – ISSUES

- According to the Pew Center on the States, Rhode Island was one of the worst funded plans in the country based on FY 2009 data
- 18 states were more than 80% funded
- 26 states between 60% and 80% funded
- 6 states were less than 60% funded
  - Rhode Island was 59% funded at the time

PENSIONS – FUNDED RATIO
1993-2004 VALUATIONS (STATE EMPLOYEES)



PENSIONS - 2005

Benefits in 2005

- Eligibility: 28 years at any age or age 60 w/10 yrs.
- Total max benefit of 80% at 35 years of service
- 3% annual COLA after 2 years

Cost

- FY 2006 budget: State cost = 16.96% of payroll, incl. 13.13% to amortize unfunded liability (UAAL)
- FY 2005 was 11.51% w/ 11.19% for UAAL
- State employees paid 8.75% (statutory)

PENSIONS - 2005

	Assembly Changes*
Eligibility	Age 59 & 29 yrs; 65 & 10 yrs
Benefit Accrual	75% at 38 years
COLA	CPI with 3% max 3rd Anniversary

**Followed Governor's proposal except for eligibility of age 60 & 30 years*

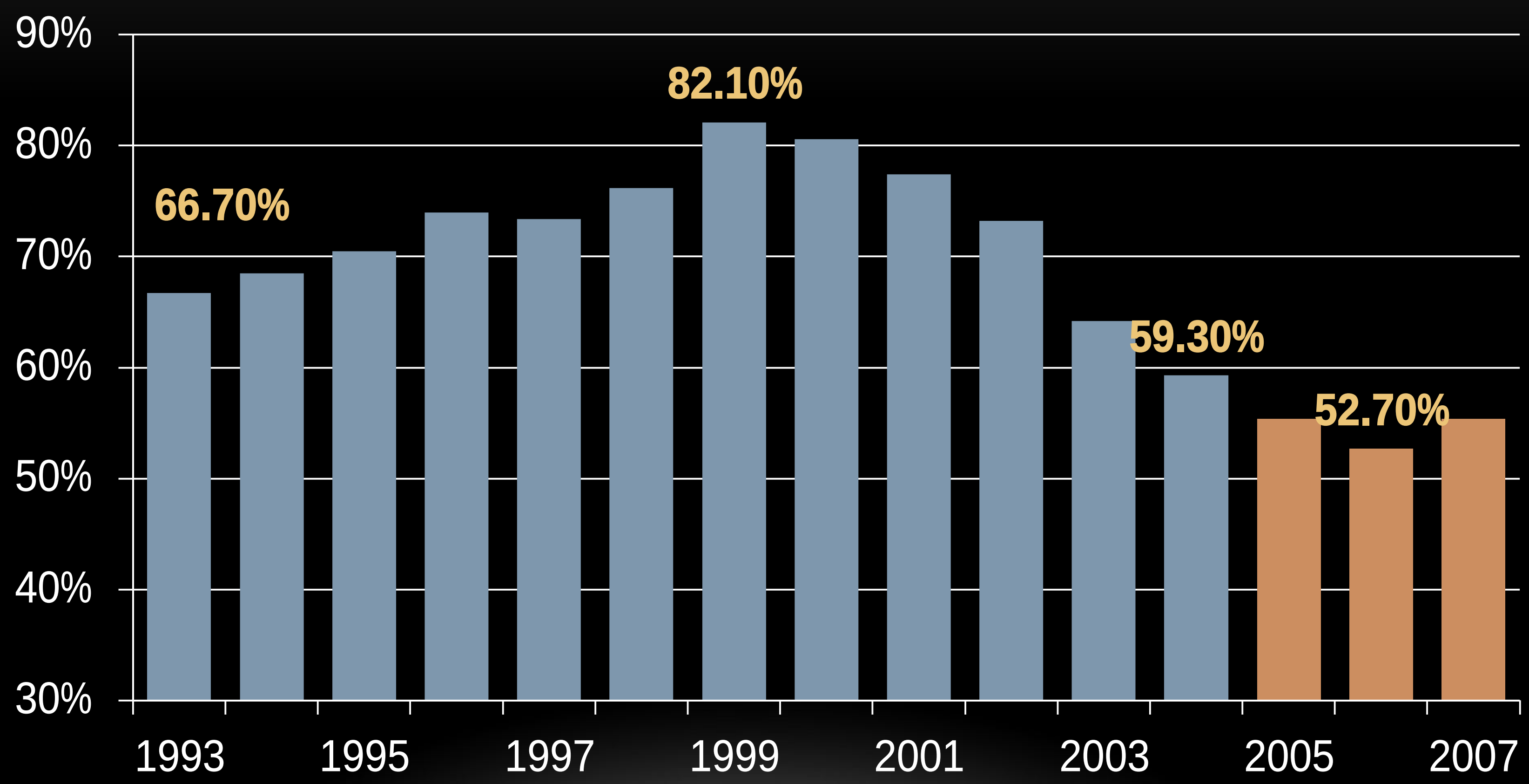
RETIREE HEALTH - GASB

- GASB mandated that governments include unfunded liability of post employment benefits as part of financial statements
- 2008 legislation set up framework for actuarial funding effective July 1, 2008
  - Included significant reductions in benefits to those retiring after October 1, 2008
  - Employees now must have at least 20 years of service and be age 59 to access state subsidy

RETIREE HEALTH – POST FY 2008

- Pre-reform, retiree health was 3.67% of payroll (pay-go) and was projected to be 6.74% with no benefit change
- For FY 2012, it is 6.86% based on 2009 valuation even with the benefit reductions – health care cost growth revised upward from earlier
- Surge of retirees because of this change impacting both retiree health and the retirement systems

PENSIONS – FUNDED RATIO
1993-2007 VALUATIONS *(STATE EMPLOYEES)*



PENSIONS - 2009

- Despite changes, contribution rates continued to increase and funding ratios declined as asset losses have continued
- Not enough savings to the state from making new changes that only affect non-vested and new employees
- Governor proposed further pension changes during 2009 Session to resolve approximately 1/3rd of the budget deficit

PENSIONS – 2009: GOVERNOR'S PROPOSAL

- End COLA for all employees
- Age 59 minimum for all employees
- Apply to those not eligible to retire by July 1, 2009
- Original proposal applicable to those not *retired* by April 2009 with a number of things not fully vetted
    - Legal issues, impact on classrooms, retirement system liability and state government with mass retirements

PENSIONS – 2009: HOUSE COMMISSION RECOMMENDATION

- House created a special commission in 2008 to study the pension issue -- Met from February 2008 to March 2009; Final report June 2009
- Age 65 w/ actuarial reduction to retire at age 62
- Non-compounded COLA at lesser of CPI or 3% beginning 1st anniversary after age 65
- Salary basis = 5 highest consecutive years (was 3)
- Apply to all not eligible to retire by July 1, 2009
- State should consider adopting new hybrid plan for future employees – no further action/study

PENSIONS – 2009: RETIREMENT AGE

- Nearly half of employees were in Plan A
- Major “cliff effect” potential
  - Generally, when changes are made, some employees are fully affected but others not at all

PENSIONS – 2009: RETIREMENT AGE

Proportional Change

- Plan A had no minimum age
  - Plan B minimum already 59
- Recognize extent to which employee is near retirement eligibility (28 years of service)
- Decrease impact of age requirement on basis of years served
- Affected employees have customized retirement age

PENSIONS - 2009: ASSEMBLY ACTION

- Age 62 minimum applied proportionally to time earned toward retirement
  - Largest affect on Plan A members
- Freeze Plan A accruals on October 1, 2009 and accrue at lower Plan B rates thereafter
- Salary basis is 5 highest consecutive years (was 3)

PENSIONS - 2009: ASSEMBLY ACTION

- Set COLA at lesser of CPI or 3% beginning 3rd anniversary for all
  - Plan B already had this COLA
- Apply changes to all employees not eligible to retire as of Oct 1, 2009
- Increased disability pension standard
- All time bought on actuarial basis

PENSIONS - 2009: JUDGES

	Was	Is*
Eligibility	Age 65 & 20 yrs; 70 & 15 yrs	
Benefit Accrual	100% full; 75% reduced – avg 3 highest yrs	80% full; 65% reduced – avg 5 highest years
COLA	3% simple	3% simple on first $35,000 on 3rd anniv. or age 65

*Applies to judges hired after July 1, 2009 -$35k limit from 2010 Assembly

PENSIONS – 2009: STATE POLICE

	Was	Is*
Eligibility	20 yrs & must retire at age 62	25 yrs & must retire at 30 yrs
Benefit Accrual	50% of final salary + 3% per year over 20	50% of final salary + 3% per year over 25
COLA	$1,500 annually	

*Applies to state police hired after July 1, 2007

PENSIONS – 2010: COLA REDUX

- Governor resubmitted plan to eliminate the COLA to solve 20% of a new, larger deficit
- Less than 6 months after Assembly adopted new plan
- Essentially same teachers and state employees affected by 2009 changes
- Assembly once again considered numerous COLA options

PENSIONS – 2010: COLA REDUX

Assembly considerations

- Should there be one?
  - Inflation decreases pension over time
  - Costs tend to increase over time
- When should it start?
- What amount should it be?
- Should it compound?
- Should it apply to entire pension?

PENSIONS – 2010: COLA REDUX

- Assembly further reduced COLA by limiting its application to the first $35,000 of a pension, indexed to inflation but capped at 3% beginning on later of 3rd anniversary of retirement or age 65
- Applied to all not eligible to retire as of enactment (June 12, 2010)

PENSIONS – 2010: COLA REDUX

- Assembly considered value of benefit compared to employee contribution
- Gov. plan would have reduced value of the benefit (normal cost) below their contributions

	Employee	Normal Cost	
	Current	*Gov.*	*Enacted*
State Employees	8.75%	8.46%	9.26%
Teachers	9.50%	9.12%	10.00%

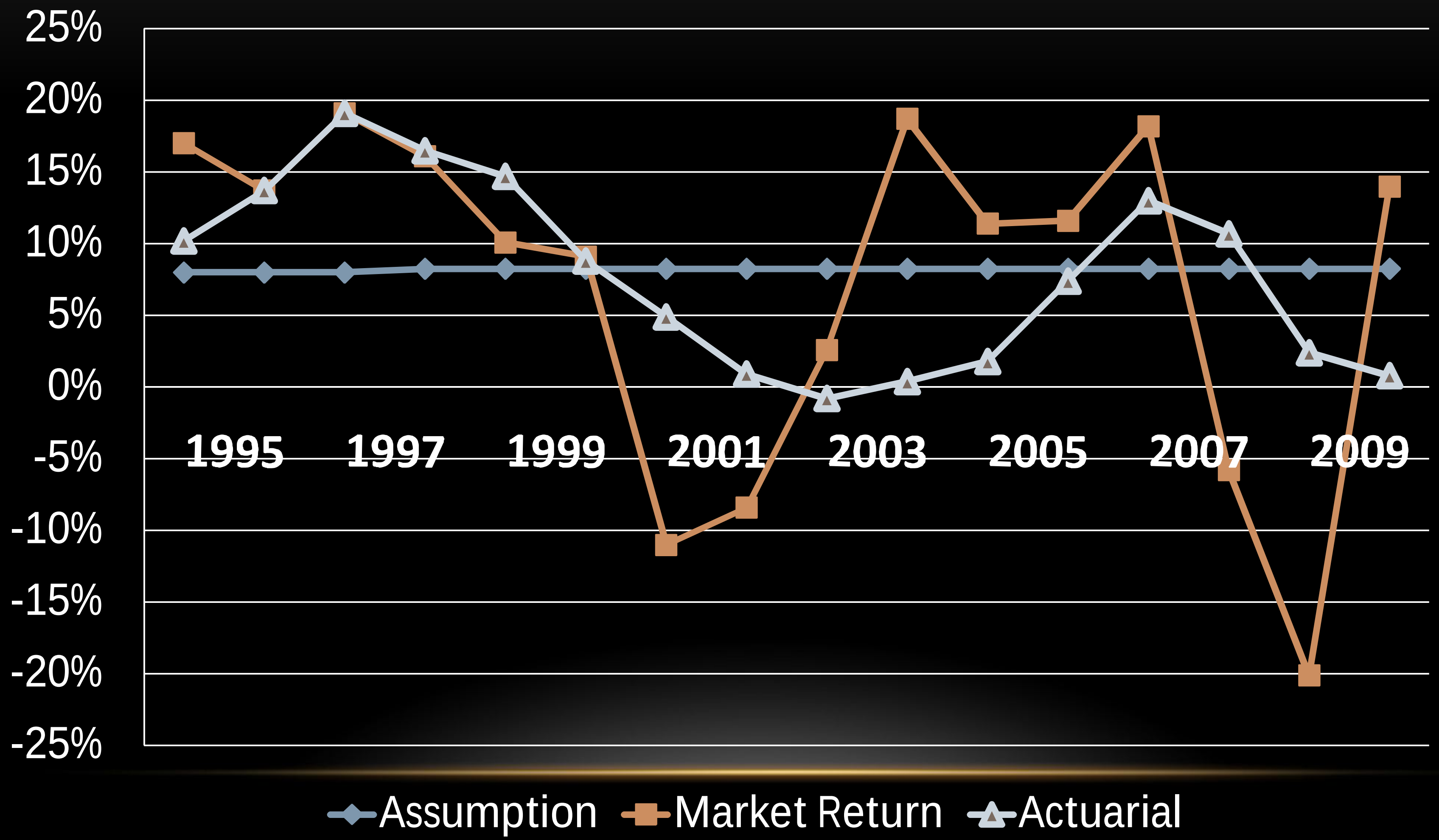
PENSIONS – NORMAL COST

- Higher returns produce lower normal costs and lower unfunded liability
- Lower returns produce higher normal cost and higher unfunded liability
- As of FY 2010 , investment data shows
  - 2010 return was 12.5%
  - 5-year return was 3.5%
  - 10-year return was 4.0%

PENSIONS – RATE OF RETURN

- Board increased assumed rate of return in 1997 to 8.25% from 8.0%
- Average return from 1984 – 1997 was 14.7%
- Average return from 1993 – 1997 was 12.85%
- Board voted in 2011 to lower rate to 7.5%

INVESTMENT RETURNS

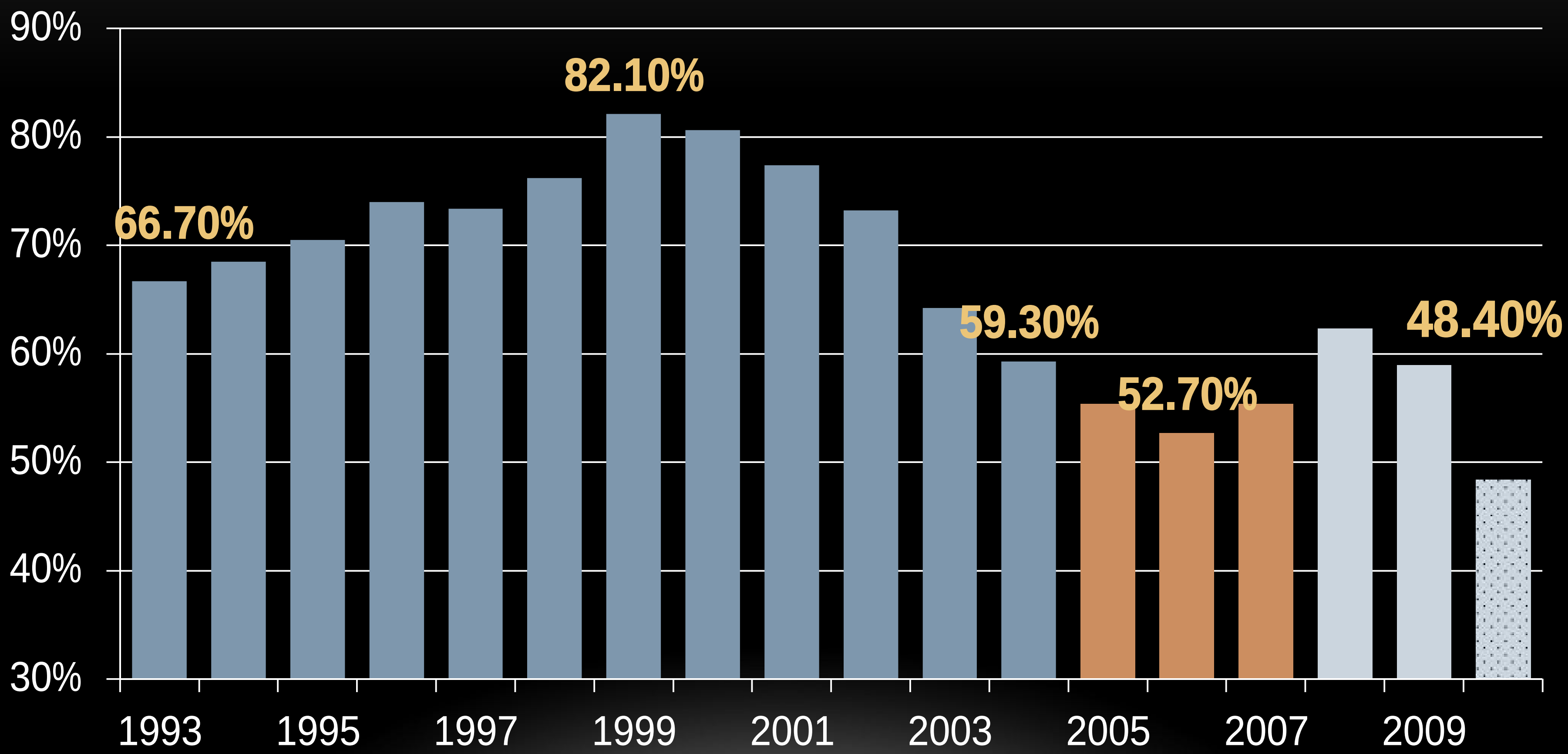


2011 ACTUARIAL EXPERIENCE STUDY

Major Adopted Changes:

- Lowered rate of return assumption from 8.25% to 7.5%
- Lowered inflation rate assumption from 3% to 2.75%
- Increased life expectancy

PENSIONS – FUNDED RATIO
1993-2010 VALUATIONS (STATE EMPLOYEES)



PENSIONS – FUNDING RATIOS

- Funding Ratios: Value of actuarial assets vs. liability
- Plan design and earnings assumptions

	FY 2011	FY 2012	FY 2013
State Employees	62.3%	59.0%	48.4%
Teachers	61.0%	58.1%	48.4%
Judges	91.0%	88.3%	77.8%
State Police	79.6%	79.8%	69.7%

PENSIONS – UNFUNDED LIABILITY

- Liability amortized over 30 years beginning FY 2002
  - Reset as part of multi part plan submitted with Governor Almond's FY 2002 budget to the 2001 Assembly which approved the measures
- Actuaries annually calculate rate needed to reach that goal
- Rate increases because of liability changes and payroll size
- Amortization payments = majority of system costs

PENSIONS – UNFUNDED LIABILITY

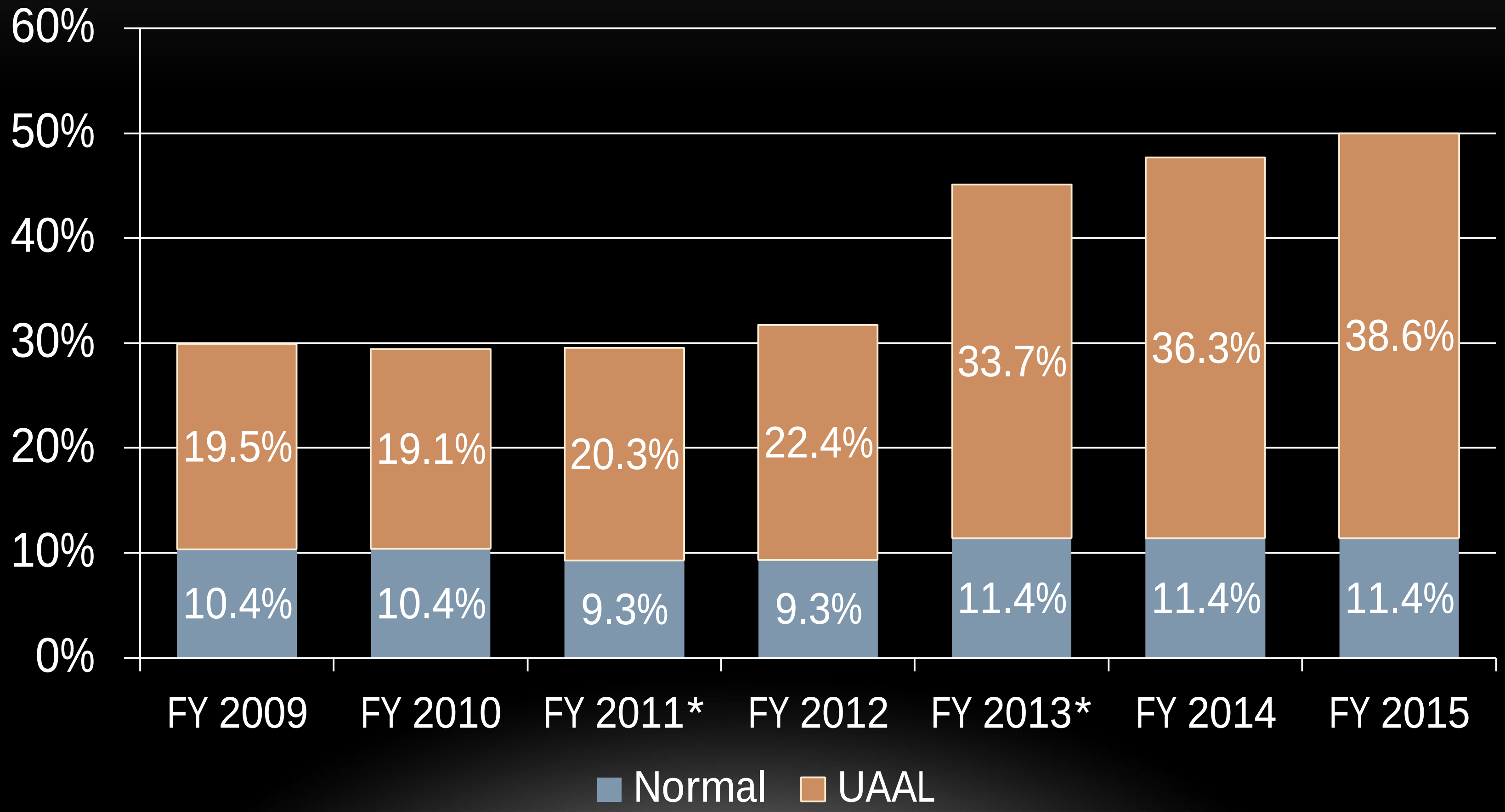
- Failure to meet earnings assumptions
- Benefits granted for which there were not adequate contributions (Pre -1990)

In millions	FY 2011	FY 2012	FY 2013
State Employees	$1,631.1	$1,836.2	$2,700.5
Teachers	2,587.1	2,892.0	4,133.2
Judges	7.8	4.9	10.9
State Police	14.1	15.2	28.5
Total	**$4,240.1**	**$ 4,748.3**	**$6,873.1**

PENSIONS – ACTUARIAL COST

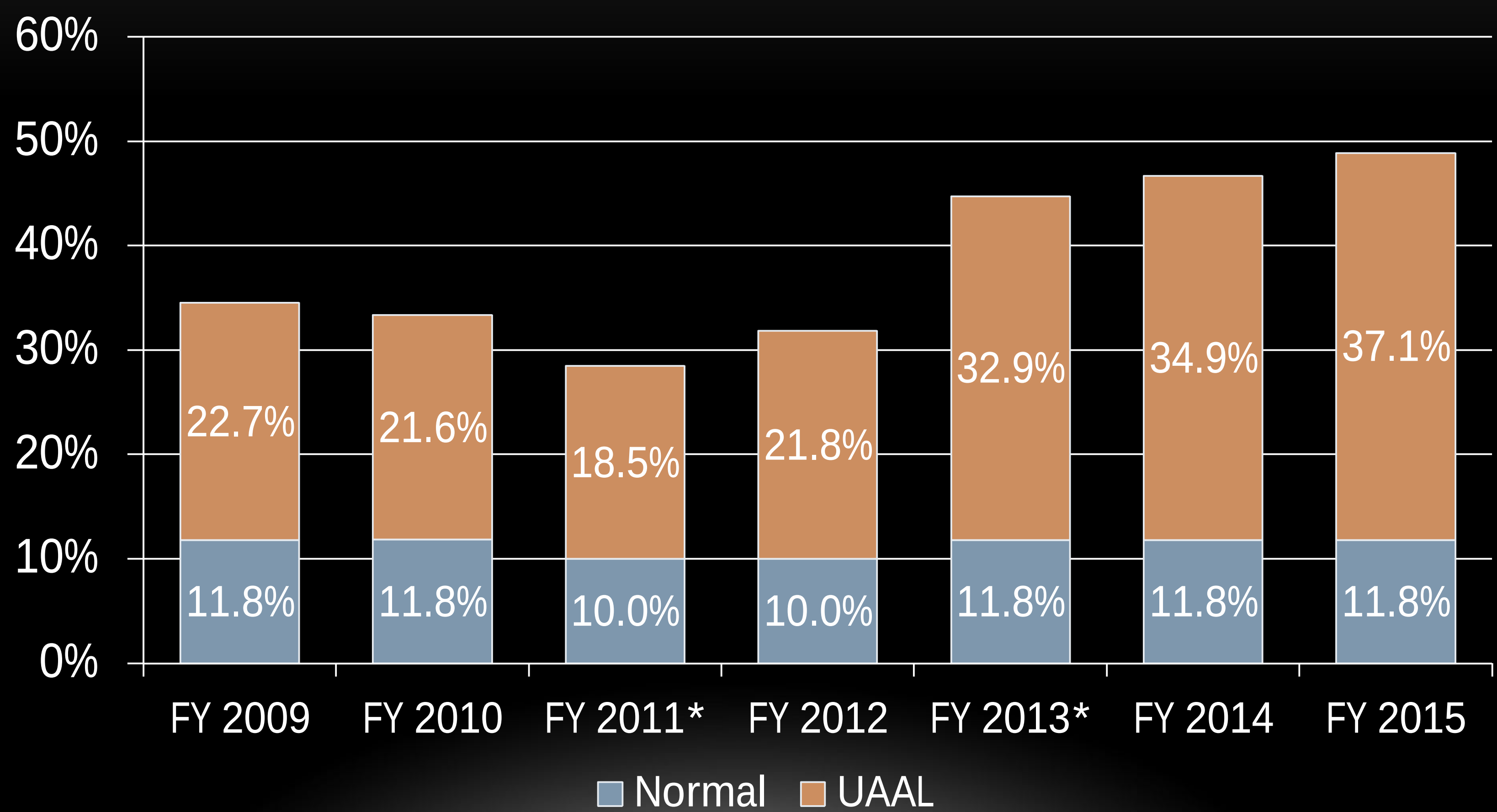
- Actuarial Cost includes
  - Normal Cost
  - Amortization of unfunded liability
  - Varies by plan

PENSIONS – ACTUARIAL COST: STATE EMPLOYEES



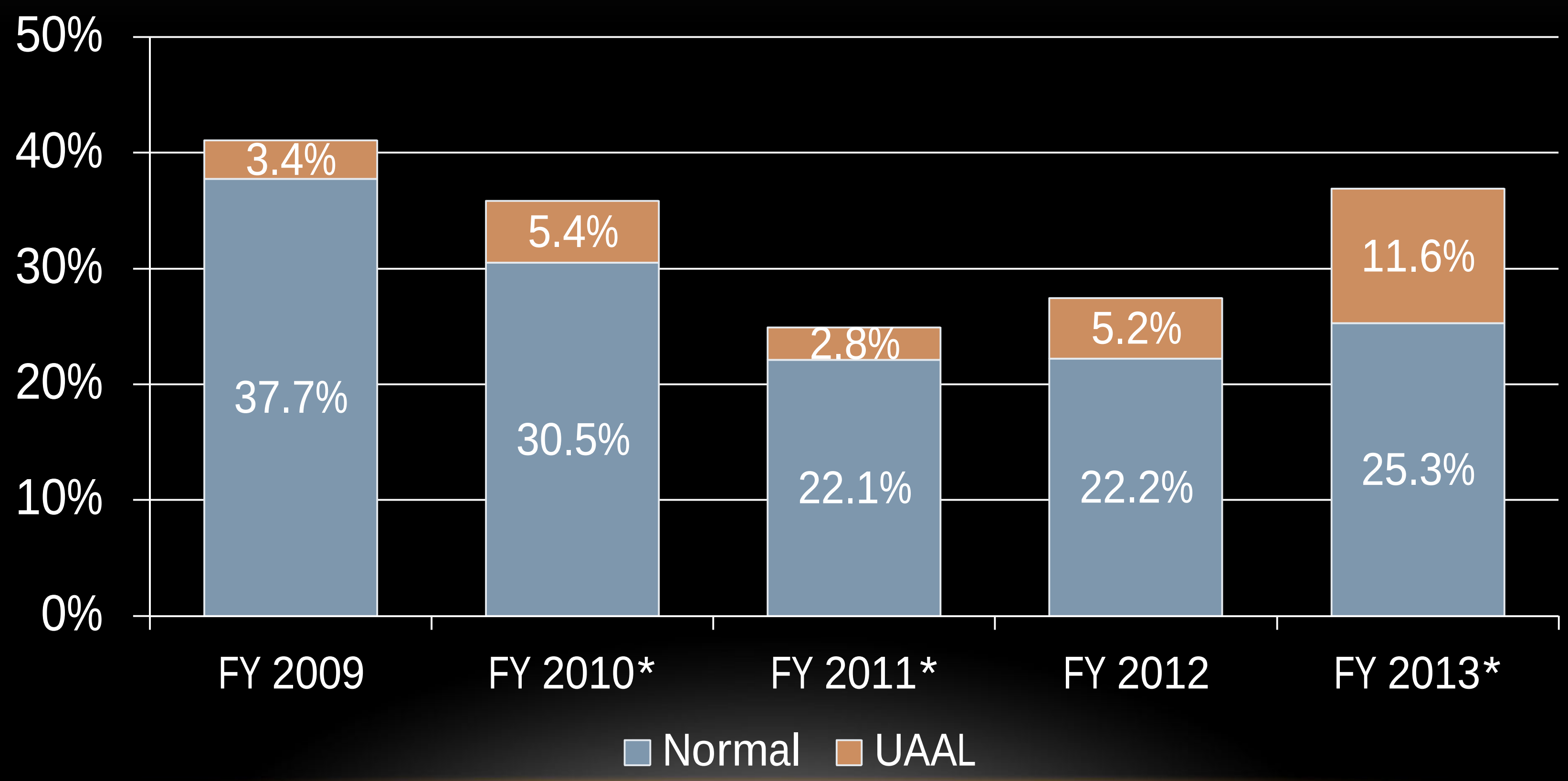
**Benefit or assumption change*

PENSIONS – ACTUARIAL COST: TEACHERS



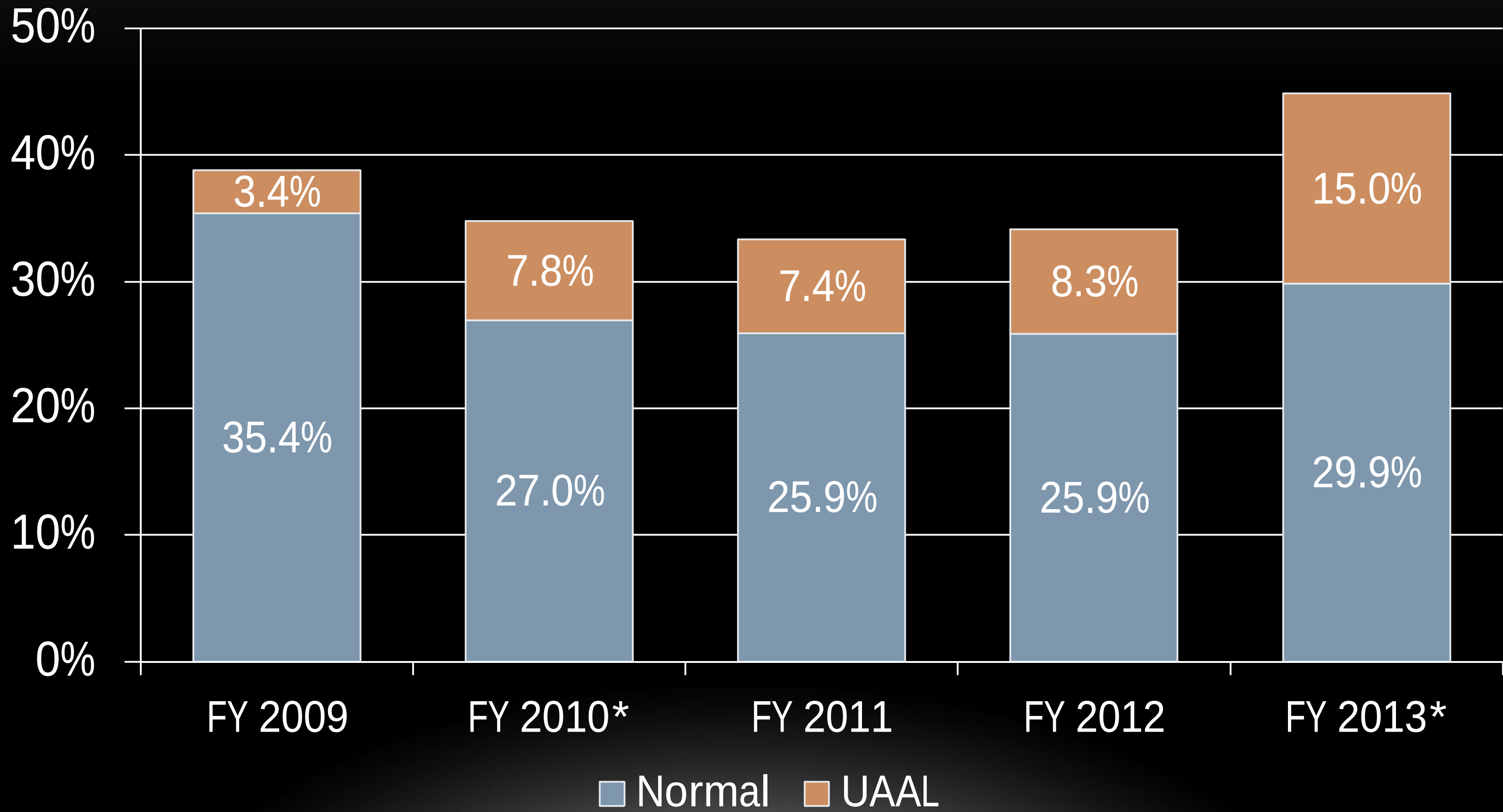
**Benefit or assumption change*

PENSIONS – ACTUARIAL COST: JUDGES



Benefit or assumption change

PENSIONS – ACTUARIAL COST: STATE POLICE

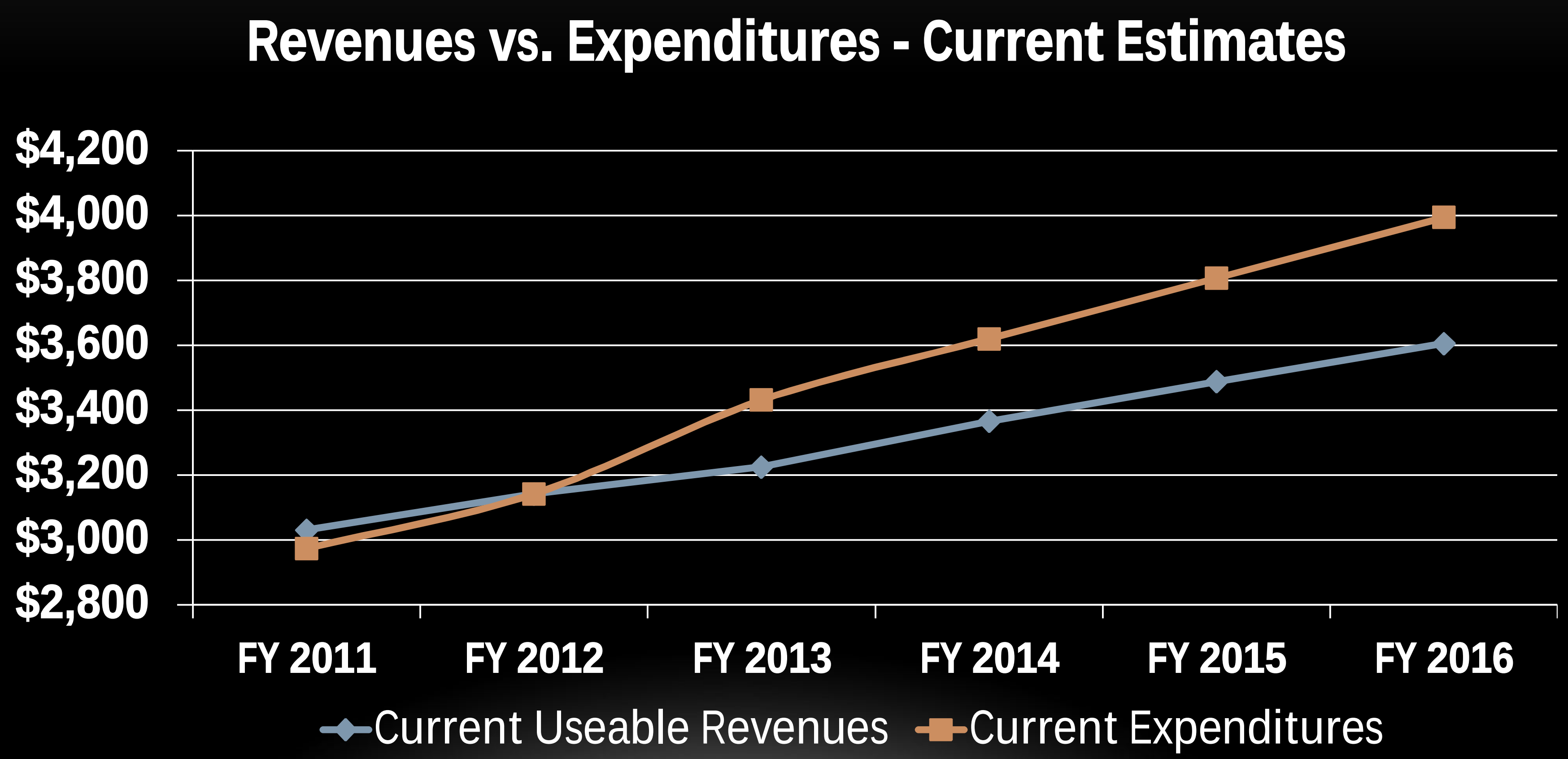


**Benefit or assumption change*

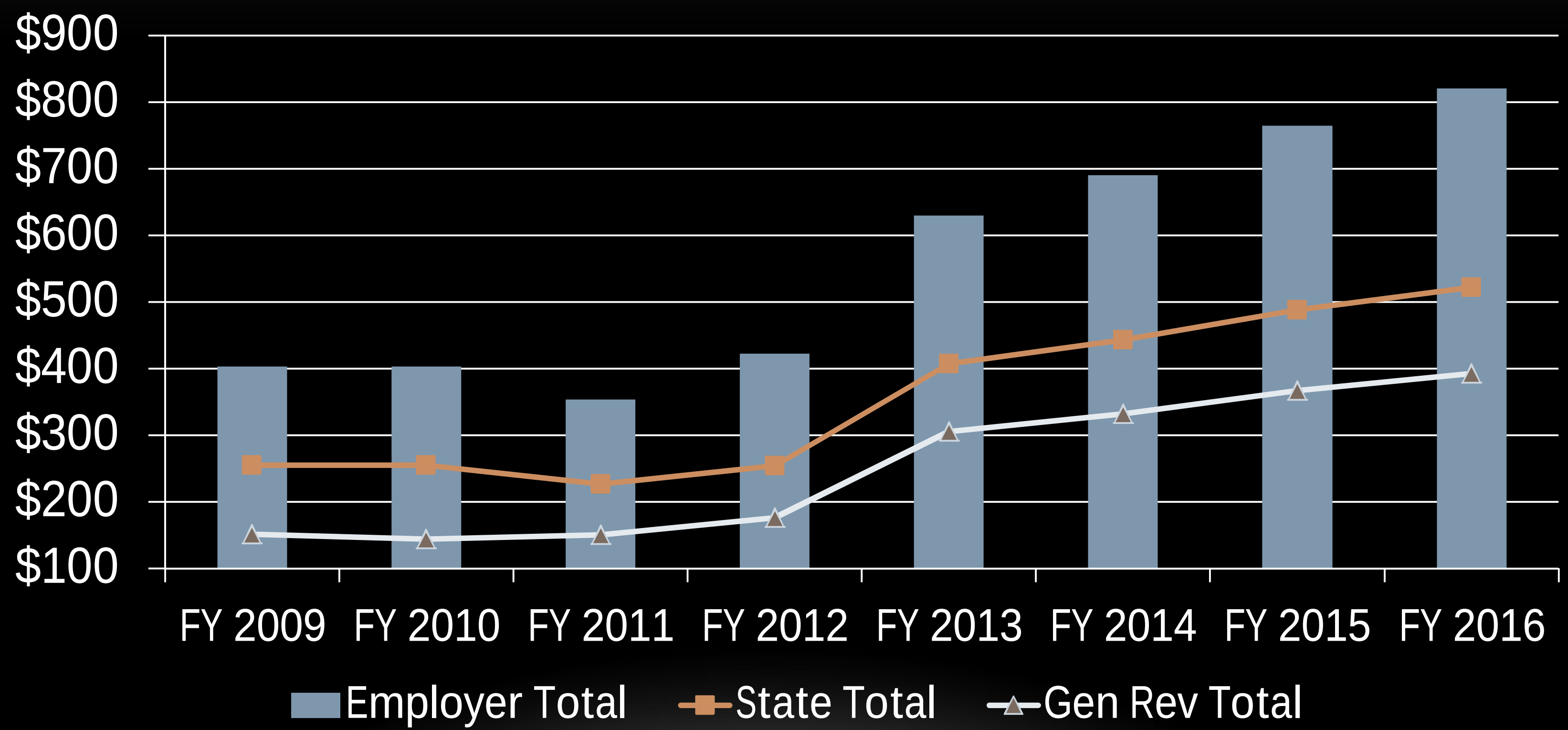
WHY DOES IT MATTER?

- Current projections have pension costs consuming larger proportion of resources
- State struggling to emerge from most recent economic downturn
- Still facing structural deficits in five-year forecast
  - No near term projection to grow our way out of the problem

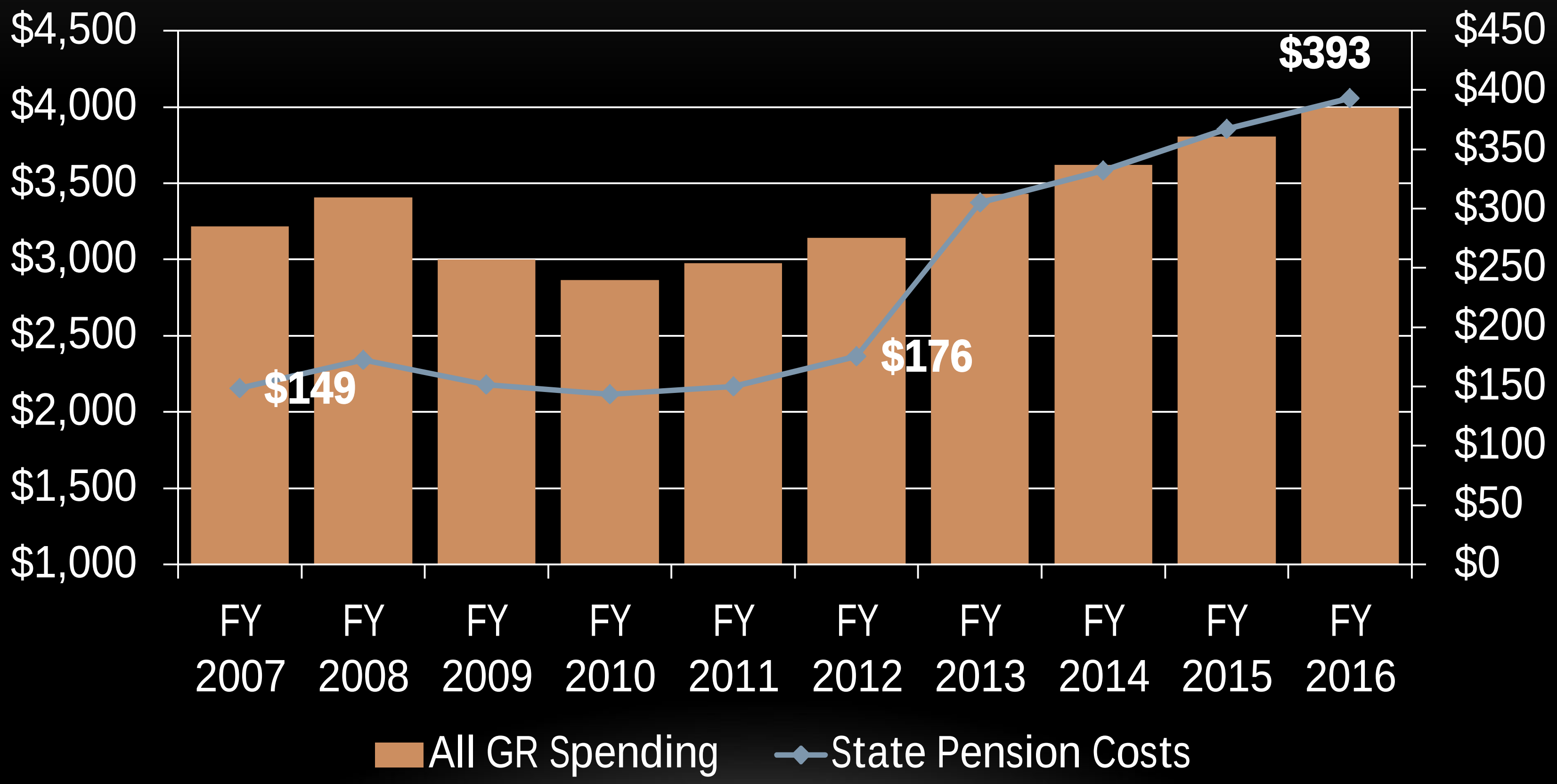
BUDGET AND OUT YEARS



EMPLOYER CONTRIBUTIONS



PENSION COSTS COMPARED TO TOTAL GENERAL REVENUE BUDGET



WHY DOES IT MATTER?

- Rating agencies consider this when evaluating state’s overall fiscal health
  - Affects ability to borrow
- Budget is about choices
  - Increasing costs for certain items limit options for investments for other priorities

LOCAL PENSION COSTS

- This presentation excluded local pensions
  - Except for local district costs for teachers

- *Next week's briefing…*

MUNICIPAL PENSION PLANS

September 21, 2011

- Characteristics of Municipal Pension Plans
  - MERS – State Administered
  - Locally-Administered
- Financial Status of Municipal Pension Plans
- Review of Other Post-Employment Benefits

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