A Guide to Comprehensive Pension Reform

Part I: Diagnosing the Problem

January 24, 2012

Presented by the Office of the General Treasurer
Gina M. Raimondo
Purpose of this Pension Workshop

• While the General Treasurer has no authority over locally administered pension plans, the office is committed to maintaining an open door policy to assist Rhode Island’s communities.

• Recognizing that each locally administered plan has unique features, this presentation is intended to facilitate a discussion within communities on how to assess their locally administered pension plans, and how to objectively evaluate possible modification options.

• This presentation is intended to offer guidance by providing steps and processes that were used to develop the Rhode Island Retirement Security Act (RIRSA). There’s no “one size fits all” solution and municipalities should take into account their own unique features.
RIRSA Principles of Pension Reform

- Commit to obtaining objective and accurate data.
- Understand the cost drivers of your pension plan.
- Focus on developing comprehensive and long-term solutions (Avoid short term budget fixes).
- Engage key stakeholders to ensure input and discussion.
- Conduct an open and transparent process, and share information with stakeholders.
RIRSA sets forth required actions to fix ailing locally administered pension plans.

RIRSA ensures municipal leaders are ultimately responsible for their locally administered plans. Please review RIGL Ch. 45-64.

**April 1, 2012:** Submit an actuarial experience study and actuarial valuations. {RIGL 45-64-6(1)}

**November 1, 2012:** Submit a comprehensive plan for fixing the at-risk plans municipal plans. {RIGL 45-64-6(2)}

Submissions are made to the Local Pension Plan Study Commission. {RIGL 45-64-6(1)}
Retirement boards have fiduciary responsibility for all aspects of their pension plans.

- Ensure that your Board members and individuals administering your pension plans understand their fiduciary duty.

- Routinely conduct fiduciary training sessions for retirement boards.

- Exclusive Benefit Rule (Duty of Loyalty): Act solely in the interest of plan participants and beneficiaries with the exclusive purpose of providing benefits to them.
Steps Leading to RIRSA

1. Conduct diagnostic of current system.
2. Understand implications on all stakeholders.
3. Set goals and parameters.
4. Assess options and develop plans.

All steps are critical, but must be tailored to the unique circumstances of the municipal plans.

Steps 3 & 4 will be discussed next meeting.
1. Conduct Diagnostic of Current System

1. Conduct diagnostic of current system
2. Understand implications on all stakeholders
3. Set goals and parameters
4. Assess options and develop plan

Key activities and analysis

A. Compare actual to projected experience and performance. Engage a qualified actuary to conduct an “experience study” to assess mortality rates, retirement timing/patterns, investment rate of return, and wage growth.

B. Describe key statistics of current system. Assess and catalogue key statistics of current system. Based on new assumptions from experience study, including rate of return projections, develop an accurate, comprehensive picture of your pension plan’s current assets and liabilities, and resulting unfunded liability and funding ratio.
A. Compare Actual to Projected Experience and Performance: Considerations and Suggestions

Obtain Accurate Numbers and Complete an Analysis of Data

Retain a Qualified Actuary

• This may require a request for proposal (RFP).
• In March of 2011 ERSRI drafted a RFP for actuarial services.
A. Conduct an experience study and updated valuation

Key actuarial assumptions

• Economic assumptions
  – Price inflation (CPI)
  – Investment return
  – Salary increases (for individuals)
  – Payroll growth rate (for plan as a whole, or overall budget growth)
  – COLA provisions

• Demographic assumptions
  – Mortality (Active Members & Retirees)
  – Disability
  – Retirement
  – Other terminations

Experience Study Due April 1st
B. Key Statistics of Current System: Considerations and Suggestions

AREAS OF ANALYSIS
(once experience study is completed and assumptions updated)

Actuarial Valuation:

i. Determine your funded ratio.

ii. Ratio of employees to retirees.


Further Analysis:

i. Assess risk parameters:
   - Normal cost of employee pension at assumed rate of return and lower rates of return (for example, actual 10 year return).
   - Budget amount dedicated to the pension as projected for next 20 years assuming payment of full ARC. Same question assuming lower rate of return.

ii. Level of post retirement income the current system is designed to provide.

iii. Current pension of retirees relative to final average salary.
The following slides are for illustrative purposes only and the data is from analysis of the state employee pension system. The slides are designed to display the different categories of data that may be helpful to municipalities in analyzing their pension plans. The data will vary for each plan and should be analyzed accordingly.
Quantify your Assets and Liabilities to Determine your Funded Ratio

State Employees

Accrued Liability: $5,233
Funded Ratio: 48.4%

Liabilities: $5,233
Assets: $2,532

Unfunded Accrued Liability: $2,701
Current Assets (Smoothed): $2,532
## Valuation Results ($ in millions)

<table>
<thead>
<tr>
<th>Valuation Results</th>
<th>Total</th>
<th>Current Retirees and Eligible to Retire</th>
<th>Current Actives</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Accrued Liability</td>
<td>$5,204</td>
<td>$4,284</td>
<td>$920</td>
</tr>
<tr>
<td>2. Assets</td>
<td>2,532</td>
<td>2,206</td>
<td>326</td>
</tr>
<tr>
<td>3. Unfunded actuarial accrued liability</td>
<td>$2,672.0</td>
<td>$2,078.3</td>
<td>$593.7</td>
</tr>
<tr>
<td>4. Funded ratio</td>
<td>48.66%</td>
<td>51.49%</td>
<td>35.45%</td>
</tr>
<tr>
<td>5. FY 2012 Projected Contributions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employer Normal Costs</td>
<td>25.3</td>
<td>4.9</td>
<td>20.1</td>
</tr>
<tr>
<td>Amortization Payments</td>
<td>221.2</td>
<td>172.1</td>
<td>49.2</td>
</tr>
<tr>
<td>Total Employer Contributions</td>
<td>$246.5</td>
<td>$185.8</td>
<td>$60.7</td>
</tr>
<tr>
<td>As a percentage of Payroll</td>
<td>36.85%</td>
<td>27.78%</td>
<td>9.07%</td>
</tr>
<tr>
<td>Employee Contributions</td>
<td>55.1</td>
<td>8.9</td>
<td>46.3</td>
</tr>
<tr>
<td>Total</td>
<td>$301.6</td>
<td>$194.7</td>
<td>$106.9</td>
</tr>
</tbody>
</table>

Assets for Current Actives equal to member contribution balances, all other assets allocated to Retirees

**For State Employees**
How many retirees and active members are in your system?

For State Employees

<table>
<thead>
<tr>
<th>Year</th>
<th>Active Members</th>
<th>Retirees &amp; Beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>13,305</td>
<td>9,250</td>
</tr>
<tr>
<td>2001</td>
<td>13,594</td>
<td>9,225</td>
</tr>
<tr>
<td>2002</td>
<td>13,795</td>
<td>9,426</td>
</tr>
<tr>
<td>2003</td>
<td>13,281</td>
<td>9,398</td>
</tr>
<tr>
<td>2004</td>
<td>12,957</td>
<td>9,674</td>
</tr>
<tr>
<td>2005</td>
<td>12,789</td>
<td>9,893</td>
</tr>
<tr>
<td>2006</td>
<td>12,817</td>
<td>10,041</td>
</tr>
<tr>
<td>2007</td>
<td>12,572</td>
<td>10,163</td>
</tr>
<tr>
<td>2008</td>
<td>11,970</td>
<td>10,396</td>
</tr>
<tr>
<td>2009</td>
<td>11,023</td>
<td>11,142</td>
</tr>
<tr>
<td>2010</td>
<td>11,421</td>
<td>11,122</td>
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</tbody>
</table>
State contribution rates and future trends (absent reform)

For State Employees

Based on Estimated Actuarial Value of Assets as of June 30, 2011

- Assumes ARC met each year and actual investment return of 7.50% during each year
- Assumes continuation of current amortization policy and current member rate
- Payroll grows at assumed 3.75% per year
State contribution rates and future trends assuming different rates of return (absent reform)

For State Employees

Rate of Return:
- Actual FY 2011 Return, 9.00% each year thereafter
- Actual FY 2011 Return, 7.50% each year thereafter
- Actual FY 2011 Return, 20% for FY 2012 & 7.50% thereafter
- Actual FY 2011 Return, 6.00% each year thereafter

• Expected ARC at each valuation date based on stated return during each year
• Assumes continuation of current amortization policy and current member rate
• Payroll grows at assumed 3.75% per year
Normal cost of employee pension at different rates of return.

A key concept in pension accounting is the normal cost, which is the amount required to be paid in any given year to fund the cost of pension benefits earned during the year. It does not include any unfunded liability costs.
Budget amount dedicated to the pension as projected for next 20 years assuming payment of full ARC. Same question if investment rate of return in the next 20 years is lower than the assumed rate of return.

- Assumes investments hit the assumed rate of return of 7.5%
- Compare these results to projected total budget
What level of post retirement income does the current system provide?

<table>
<thead>
<tr>
<th>Years of service</th>
<th>Schedule A</th>
<th>Schedule B</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>17%</td>
<td>16%</td>
</tr>
<tr>
<td>20</td>
<td>36%</td>
<td>34%</td>
</tr>
<tr>
<td>25</td>
<td>51%</td>
<td>44%</td>
</tr>
<tr>
<td>30</td>
<td>66%</td>
<td>55%</td>
</tr>
<tr>
<td>35</td>
<td>80%</td>
<td>68%</td>
</tr>
</tbody>
</table>

Does not factor in social security retirement income. See next chart for social security factored into retirement income.
What level of post retirement income do the current employees receive?

Assumes member continues active employment with the State until retirement.
Current pension of retirees relative to final average salary.

Note: Based on those 65 years and older with 30 years of service
2. Understand implications to all stakeholders

1. Conduct diagnostic of current system.
2. Understand implications on all stakeholders
3. Set goals and parameters
4. Assess options and develop plan

Key activities and analysis

A. Estimate contributions required by municipality, if paying full ARC.

B. Project trajectory of fund assets, test different assumptions around contribution levels and investment rate of returns.

C. Assess potential impact on public services, and/or taxes, if paying full ARC and absent pension reform.

D. Understand impact on active and retired employees if contribution levels are not met.

When completed
A. Estimate contributions required by employees and taxpayers, if paying full ARC

How much would taxpayers/employer have to pay each year to meet the ARC if benefit level and employee contributions remained the same?

Risk Assessment: Answer same question assuming lower rate of return.
B. Project Trajectory of Fund Assets

For State Employees

- Current Policy (19 year)
- Current Contribution Extended at 7.5% Investment Return
- Current Contribution Extended with 5.75% Investment Return
C. What percent of budget is pension? What would it be if you paid the ARC? What amount is affordable, sustainable, and secure for taxpayers and public employees?

![Graph showing increased pension costs for 2012-13]

- 2012-13 Increased Pension Costs for State Administered Systems
- $249 M (Estimate)
Toolkit Summary

- Ensure pension board members understand their fiduciary obligations
- Hire a qualified actuary, RFP Process (slide 8)
- Conduct an experience study (slide 9)
  - See GRS presentation
  - See PCA Presentation
- Conduct an updated actuarial valuation (slide 10)
- Conduct analysis of cost drivers, cash flow, and budget implications of your particular pension plan
  - Accurate assessment of unfunded liability (slide 12)
  - Project future contribution rates (slide 15)
  - Evaluate future contribution levels at different rates of return (slide 16)
  - Understand normal costs and unfunded liability costs (slide 17)
  - Analyze impact of future contribution levels on budget (slides 18, 25)
  - Analyze current level of post-retirement income (slides 19, 20)
  - Understand future implications on all stakeholders (slide 22)
  - Project fund asset levels at various contribution trajectories (slides 23, 24)
Questions