Pension Study Commission
March 25, 2013
Minutes of the Meeting

A Study Commission meeting was held in Room 313 of the State House, 82 Smith Street, Providence, Rhode Island on Monday, March 25, 2013.

Rosemary Booth Gallogly, Director of Revenue and Chairperson of the Pension Study Commission called the meeting to order at 10:06 AM.

Commission members present: Rosemary Booth Gallogly, Jean Bouchard, Paul Doughty, Allan Fung, Dennis Hoyle, Richard Licht, Joseph Polisena, Melissa Melone representing Gina Raimondo, John Simmons, Steven St. Pierre

Members absent: Bruce Keiser, J. Michael Lenihan, Antonio Pires, Mayor Angel Taveras

Others present: Susanne Greschner, Chief of the Division of Municipal Finance, Daniel Sherman from Sherman Actuarial Services, LLC and members of the public

Agenda Item #1 – Approval of Minutes from March 11, 2013

Chairperson Booth Gallogly asked if the Commission members had any corrections, adjustments or additions to the draft minutes provided from the Study Commission meeting held on March 11, 2013. There were none. Paul Doughty, President of the Providence Firefighters' Union Local 799, made a motion to accept the minutes as written. The motion was seconded by Mayor Polisena, from the Town of Johnston. The motion passed all in favor.

Agenda Item #2 – Moody's Special Comment - Update on Status of US, State, and Local Government Pension Data Adjustments

The Chair referred to the Moody's comment addressing the proposed update to the way Moody's looks at pension data with the goal of enabling greater comparability. The Commission's August 16, 2012 letter was attached as well which expressed concern over the policy they may be adopting, specifically multiple sets of data requirements--GASB, funding methodology, and potentially having another set of calculations performed by Moody's. One of the areas of concern raised in the letter appears to be addressed. According to the comment, "*New pension adjustments are designed to enable greater comparability of these long-term liabilities and to inform Moody's analysis of credit risk. The new adjustments will not create new reporting, disclosure or performance requirements for issuers*." The Chair stated that it does appear that Moody's listened to the Commission's concerns. She added that Moody's analysis is a comparison of nationwide pension data, not just Rhode Island. When new information is available she will be sure to pass it along.

Mayor Fung inquired as to where Moody's may be leaning and expressed concern that they may be downgrading municipalities, some as much as two notches. The Chair agreed that this is very significant.

Moody's special comment does not address this specifically but they will be looking at outliers and will take into account material plan amendments that are legally finalized that are not yet reflected in the pension data. Outliers are compared to their peers nationwide, not just locally.

Mayor Fung expressed further concern over the term *legally finalized*. At what point is it legally finalized? He stated that it would be disappointing if Moody's would not consider reforms that have been enacted but may still be subject to court challenges and could take years to finalize. Chairperson Booth Gallogly stated that this is a good question and if she has any further conversations with Moody's she will ask them to consider this.

Before beginning the testimony she called to the Commission's attention the tentative schedule with the goal of completing the FIP testimony by May 1, 2013. Chairperson Booth Gallogly noted that the Commission now has Funding Improvement Plans (FIP) for Cumberland and Pawtucket. North Providence is working on its plan. She asked the commission members to consider an additional meeting on April 15th as well as starting one hour earlier on the April 22nd date. This was agreeable to all. The Chair reminded the members that the next meeting will be held in the Senate Lounge.

Agenda Item #3a – Testimony from the City of Newport on its Fire and Police Pension Plans

Represented by: Jane Howington, City Manager and Laura Sitrin, Finance Director

Ms. Sitrin briefly described the plans which were established in the 1940's or 50's. The City has been taking steps for at least the last 10 years to increase the payments into the plan even though they are underfunded. They are fully funding the ARC. Three years ago, the City reduced the plans' interest rate of return from 8.25% to 7.5% which increased the plans' liability and made the funding look worse. She noted another step taken was to change from a rolling thirty year amortization to a declining amortization. Given these steps, Ms. Sitrin stated they are doing the right thing and added that pension funding is a major issue in the City. The Council, residents and the administration are all very much aware of the issues. They have had some success with the fire plan and are beginning negotiations with the police plan. Since they are in the middle of this process, she cannot get into details. Each of the plans has approximately 200 participants in each plan (actives and retirees) and neither is a closed plan.

Chairperson Booth Gallogly asked that they describe the process they went through in selecting Option 1. Ms. Stitrin stated that they did follow the Commission's requirements and came up with four alternatives—Option 1 was to continue what they were doing, Option 2 would put new hires into MERS, Option 3 would change the plan provisions to match MERS, and Option 4 would seek an alternative means of providing fire or police services to the City. The City did make the decision to go with Option 1. Ms. Stirin added that this does not mean they are not looking at other options but they will do this through the negotiation process.

The Chair directed the Commission to the summary handouts showing the various options, in particular page 4, showing the adopted option which is Option 1. Ms. Sitrin confirmed that this option was adopted by the City Council. The plans will be 60% funded in 2024 for the fire plan, and in 2019 for the police plan. They are using the actuarially required mortality tables.

Mayor Polisena welcomed them both and asked Ms. Howington how much state aid the City of Newport lost through cuts in state aid. She replied that the City of Newport was cut $4 million in general revenue sharing. Mayor Polisena stated that his community lost $10 million and he is looking forward to his testimony where he will bring handouts showing what people are collecting for pensions. He added that Governor Carcieri cut cities and towns. There was also no relief from state mandates. Now, with people wanting the ARC fully funded and the cost of daily operations of running a municipality, he felt that some people didn't understand the expense to the taxpayer. Ms. Howington agreed that in order to meet the City's goals of funding the ARC, something else would need to be cut. She provided an example of capital expenditures which is often what suffers.

Mr. Hoyle inquired as to why Option 3 was not more fully explored since it has a lower ARC and gets the City out of critical status in a little bit less time as Option 1. Ms. Howington stated that they considered that option, as they did all the options presented. She summarized that due to the upcoming negotiation process it was difficult to elaborate on this. Chairperson Booth Gallogly thanked Ms. Howington and said that she respected this.

The Chair then continued with the testimony questions related to plan governance, investing, and fiduciary responsibility. Specifically, the Chair asked which body governs the award of service and disability pensions. With regard to governance of the plans, Ms. Sitrin stated that the City Council acts as trustees over the plan and the Council has delegated the calculation of the award to human resources and finance departments. Ms. Sitrin explained that the calculation is pretty straightforward.

Based on this response the Chair asked if the City Council makes the decision on a disability pension award or whether the finance department does this. Ms. Stitin replied that it must go through the various departments. Ms. Howington added that based upon the advice of the city lawyer, human resources, and finance office, she would then authorize this.

The actuarial assumptions are delegated to the finance department. There are no meeting minutes for the award of pension but they are required by City Charter to have a trust and investment commission to oversee the management of pension funds, scholarship and trust funds, and OPEB trust funds. This body is interviewed by, selected and appointed by the City Council. There are specific requirements and experience needed to be on this commission. The chairman is a partner at Parker Brown Macaulay and Sheerin, an employee benefits law firm. Other members include a retired actuary, a retired vice president of sales management, a certified financial planner and owner of a retirement benefits solution company.

The Chair inquired if they meet regularly. Ms. Sitrin replied that they meet at least quarterly, sometimes more often. They review fund performance and asset allocation. The Chair asked whether they have received fiduciary training or attended any of the General Treasurer's trainings offered. Not only did several of them attend the fiduciary training but the chairperson also teaches this sort of training himself. The commission is staffed by the finance department but there is a separate company paying out the benefits.

With respect to MERS and acknowledging the negotiation process, Chairperson Booth Gallogly asked if there were hurdles observed, or suggestions to make it easier for a municipality to join, or are there any specific provisions that are preventing the City from being able to negotiate a transfer to MERS. This information would be helpful to know. The Chair mentioned that paying the full ARC was noted as a particular challenge for some communities but noted that Newport has already been funding the ARC. The Chair elaborated that there has been some discussion of allowing a community that was entering MERS to ramp up payments over five years to get to the ARC. Ms. Sitrin replied that the obstacle is not the ARC, but rather for the active employees, it is the significant difference in the benefits between their plan and MERS. These changes will need to be negotiated with the actives. Ms. Howington added that Newport is also analyzing the effect of new hires going in MERS and what this does to the liability with a smaller pay-in going forward. Analyzing this balance and where would the money come from is what Newport is studying now.

The Chair stated that she would appreciate ideas, and added that the Commission would want to avoid new problems by creating closed plans. Each community's real-world experience is welcomed.

Mr. Doughty asked when the investment rate of return was changed and what the actual rate of return was. Ms. Howington stated that the rate had been changed three years ago. While Ms. Sitrin did not have the figures at hand for the actual rate of return, she noted that the actuary has confirmed that 7.5% is a realistic return for their plans' asset allocations. Ms. Stitrin also answered Mr. Doughty's question that they have indeed funded 100% of the ARC.

Chairperson Booth Gallogly asked about the deterministic forecast using the 7% rate of return. It appears that the City does not get 100% funded using this rate of return. She questioned whether the assumption of a lower rate of return would require that the unfunded liability be amortized more aggressively. The Commission's actuary, Dan Sherman, stated that Newport would get to 100% and what appears to be missing is the accumulation of actuarial losses over that period of years which would be added to the unfunded liability and be reamortized. Mr. Sherman pointed out that the exhibits using the lower rate of return do nearly reach full funding. (He noted Option 1, Exhibit B-1 where this occurs in 2033 at $200,000). What is not set up on the exhibit is a mechanism where you have actuarial losses near the end and reamortize the losses. His guess is that the actuary didn't show this small piece on the exhibit and it is insignificant.

Newport stated they are familiar with the provisions of Article 11 in the Governor's proposed budget.

Agenda Item #3b – Testimony from the Town of Scituate on its Police Pension Plan

Presenting for the Town of Scituate: David Ward, Director of Actuarial Services from Angell Pension Group; Sharon Johnson, Town Treasurer; Bill Hurry, Town Councilor; and David Hanna, Town Council Vice President

Both Mr. Hurry and Mr. Hanna are also members of the Scituate Pension Board since 2011.

David Ward began by stating that as the Town's actuarial consulting firm, they have met with Scituate numerous times. For each actuarial period, it is Angell's internal policy to review the actuarial assumptions. They note what the assumptions have been and comment on them as well. The Scituate Funding Improvement Plan consists of four different studies. Exhibit A is the current funding method which has an open amortization. The first alternative is to have a closed amortization period and fund the ARC, shown in Exhibit B. Mr. Ward noted that last April the Town formally adopted a policy to fully fund the ARC. All of the alternatives presented in the FIP are based on fully funding the ARC. Last summer, negotiations with the police union began in an attempt to revise the plan. Exhibit D is the Town's most recent proposal to revise the plan.

The Chair inquired for clarification that Exhibit A was the Town's funding method as of April 2011, not an optional alternative which Mr. Ward agreed was correct. Chairperson Booth Gallogly pointed out that this exhibit shows 27% funding in 2011 with a continued decline.

Mr. Ward stated that Exhibit B reflects the Town's commitment to pay the ARC and is the recommended option. The proposed position is shown in Exhibit D—this is all subject to negotiation. This option includes a 2% non-compounded COLA for employees, and final average earnings is based on a five consecutive year average, a 12% of salary employee contribution, and lowering the accrual of benefits to 2%.

The ARC, for purposes of the Town's exhibits, is shown in the column titled *Town Contribution.* Mr. Ward referenced Exhibit D and indicated that in the year 2028 the Town would reach 60% funding and meet the objectives of the Commission.

The Chair asked Mr. Sherman to clarify the presentation of the ARC in this manner. Mr. Sherman stated that since the mid-80's, GASB 25 and 27 have required this presentation, that the ARC is the employer contribution for accounting purposes. After a brief discussion and reference to Exhibit D, it was noted that for 2012, the ARC is the *Town Contribution* column ($580,036) not the *Annual Required Contribution* column which includes the total contribution from both employee ($114,129) and employer (580,036).

Mr. Ward continued with Exhibit D and stated that the plan is 100% funded in 2038 and this funding improvement plan does not anticipate changes in assumptions nor does it anticipate funding the ARC at less than 100%. Regarding new layers of underfunding being reamortized on a 20 year basis, he indicated it would be faster to stay with the 25 year closed amortization rather than restarting a new layer over 20 years.

Mr. Sherman clarified the FIP guidelines and stated that what the commission was looking for was twenty years forward-thinking and what happens if something goes wrong. For example, assume it is 2032 and we have another market crash, how would the plan handle this? Amortize over five years? Since a five year amortization is unlikely, the communities were asked to think about such a scenario and how to address it. While the forecast may not reflect something like a market crash, the commission guideline asked for the policy on how this would be handled. Mr. Sherman likened this guideline to an emergency management policy.

The Chair directed the next question to the Town and asked if the Town understood the commitment to fund the growth of the contributions, which is in many years 3-4%. Ms. Johnson acknowledged that the Town is aware of this.

Director Licht inquired if the proposal has been accepted as negotiated. Mr. Hurry replied that the proposal has not been accepted and they are still very much in the negotiation process.

Mr. Sherman replied to Director Licht's question on the current age of retirement. For participants hired on or prior to June 30, 2000, upon completion of 20 years of service the participant is eligible for normal retirement. Alternatively, a participant may continue service beyond the 20 years. For participants hired on or after June 30, 2000, upon completion of 25 years of service, the participant is eligible for normal retirement. There is no required age of retirement.

Director Licht then asked if an age requirement was considered. Mr. Hanna stated that a change in the reduction of the accrual rate would effectively increase the retirement age. New hires would go into MERS. This is all subject to negotiation.

Mayor Fung stated that this appeared to be an open plan and inquired whether they are looking to close the plan. He asked for the number of plan participants to which Mr. Hanna replied that there are 16 retirees, and 17 actives, 33 total in plan. The Mayor cautioned that the Town should be careful in how they close a plan.

Chairperson Booth Gallogly asked Mr. Ward about any actuarial consequences in closing the plan. He replied that there will not be a strong group of new hires to fund the current plan. Scituate will have the opportunity to structure a benefit for new hires that is funded properly. Mayor Fung suggested that if Scituate closes the plan, even though the intent would be to use the savings on the transition to go towards funding the closed plan, they may fall into the same problem as Cranston. With fewer employee contributions, Mr. Ward stated that the FIP clearly illustrates this and Scituate is acutely aware of this dilemma. Mr. Sherman pointed out Exhibit D which shows covered compensation and normal costs decrease to zero; and Mr. Ward confirmed that this was not an open group forecast. Mr. Ward stated that all the alternatives proposed to the participants were as a closed plan.

Chairperson Booth Gallogy asked the Town's representatives to describe the governance of the pension plan, inquiring whether there is a board and how often they meet.

Ms. Johnson stated the plan is governed by the Pension Board, comprised of two town council members, the town treasurer, and two police officers.

The Chair then asked about the award of pensions and whether they had to meet on this issue or if this was delegated to town staff. Mr. Hanna answered by reference to the recent news report which claimed that the Pension Board had not met in ten years. He stated that he and Mr. Hurry have been on the Pension Board for two years and it has met frequently in the past two years. He further stated that they were aware of their fiduciary responsibility.

The investment advisor for the Scituate Pension Board is required to attend the meetings.

Mayor Polisena asked how much the Town was cut in state aid. Mr. Hanna replied that the cut was $1.624 million in motor vehicle tax revenue and $322,000 in general revenue sharing in 2009—essentially almost $2 million was pulled out if their budget over several years. The effect of this cut on the levy was extraordinary and painful.

The Chair inquired about the history of funding the ARC and Mr. Ward stated the underfunding goes very far back, not just in recent years. The significant underfunding occurred more than 12 years ago. Mr. Sherman then noted from the actuarial reports that from 2005 to 2007 the Town fully funded the ARC. In other years the varied funding percentages were as follows: 2011, 62%; 2010, 66%; 2009, 95%; 2008, 90%; 2002, 66%; 2001, 62%. Mr. Ward added that adverse experience also led to the underfunding including four disabilities.

Mr. Doughty asked for the average years of service for the participants. Ms. Johnson and Mr. Ward agreed that it was approximately 14-15 years of service. While there is not a mandatory age of retirement, there is a maximum benefit (60%).

Director Licht inquired if the Town knew the proposed funding for Scituate under Article 11 of the Governor's proposed budget. The Town is aware of this proposed funding of $98,000. Director Licht added that he hoped the $98,000 would go into the plan. Mr. Hurry and Mr. Hanna supported doing this and noted it would need a Council vote.

The Chair thanked the presenters and again expressed her concern over the projection shown on Exhibit A if the Town takes no action—the funded ratio will continue to decline until there is no money left. Mr. Hurry said the Town shares her concerns and they are working on it.

Agenda Item #4 – Public comments

There were no public comments.

Agenda Item #5 – Adjourn

Mayor Polisena made a motion to adjourn which was seconded by Mr. Hoyle. The meeting adjourned at 11:07 AM.

Rosemary Booth Gallogly	4/1/13

Chairperson	Date

PSC/ec

Addendum to the
March 25, 2013
Pension Study Commission
Meeting Minutes

MOODY'S
INVESTORS SERVICE

SPECIAL COMMENT

Update on Status of US State and Local Government Pension Data Adjustments

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Moody's Investors Service announced today that it expects to finalize in April its approach to making adjustments to the pension data reported by US state and local governments for use in its ratings process. Moody's continues to expect that no state ratings will be immediately affected by its pension adjustments. Among local governments, the rating agency expects that less than 2% of the total population of general obligation (GO) and equivalent ratings will be placed under review for possible downgrade. As pensions are just one of many factors Moody's considers in a rating, any downgrades resulting from the subsequent reviews are likely to be limited to two notches.

The rating agency had issued a request for comment last July seeking feedback on its proposed pension adjustments. Its final approach will be formally incorporated as part of its GO bond rating methodologies for state governments and local governments in the US next month, at which time it will also identify any ratings potentially affected by the new approach.

The affected ratings will be for those local governments whose pension obligations relative to their resources place them as significant outliers in their ratings categories. In determining such outliers, Moody's will consider available reported and adjusted pension data. It will also consider the effects of material pension plan amendments or reforms that have recently been legally finalized but are not yet reflected in reported pension data.

The new pension adjustments are designed to enable greater comparability of these long-term liabilities and to inform Moody's analysis of credit risk. The new adjustments will not create new reporting, disclosure or performance requirements for issuers.

In the original request for comment, "Adjustments to US State and Local Government Reported Pension Data," Moody's proposed four adjustments to pension data reported by state and local governments. These were: allocating liabilities of certain pension plans to governments based on how much they contribute to those plans, using point-in-time prices instead of averages to value pension assets, changing the way in which future pension benefit payments are transformed into present values, and translating these changes into an annual cost.

Moody's Related Research

Special Comment:

- Adjustments to US State and Local Government Reported Pension Data: Status Report, October 2012 (146189)

Request for Comments:

- Adjustments to US State and Local Government Reported Pension Data, July 2012 (143254)
- Adjustments to US State and Local Government Reported Pension Data: Frequently Asked Questions, August 2012 (144863)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Report Number: 151579

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August 16, 2012

Moody's Investors Service
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RE: Request for Comment: **ADJUSTMENTS TO US STATE AND LOCAL GOVERNMENT PENSION DATA -** Report Number: 143254

Thank you for the opportunity to comment on Moody's proposed adjustments to the pension liability and cost information reported by state and local governments.

This comment on Moody's proposed adjustments is offered by the Rhode Island Local Pension Study Commission (Commission) which was established by the Rhode Island General Laws as part of the State's overall pension reform efforts. The Commission was formed to assess the funded status of the locally-administered government pension plans within the State of Rhode Island and to provide recommendations to the General Assembly regarding objectives to improve their funded status. The near term focus of the Commission is to receive and react to funding improvement plans for each of the local plans deemed to be in critical status (funded ratio less than 60%). Such funding improvement plans are required no later than November 11, 2012. The Commission membership is enclosed as an attachment.

Generally, the Commission is opposed to those measures and adjustments proposed by Moody's that differ substantially from the accounting provisions included in the most recent pension accounting standards issued by the Governmental Accounting Standards Board (GASB) in June 2012 – Statements No. 67 and 68 as applicable to plans and employers, respectively.

One of the objectives of having a recognized standard setting body designated to promulgate generally accepted accounting principles (GAAP) for governments – the Governmental Accounting Standards Board – is to enhance the consistency and comparability of reported financial information by state and local governments. Through the existence of the GASB and their promulgation of generally accepted accounting standards combined with the independent auditors' assessment of conformance with those standards a mechanism to ensure consistency and comparability of financial data reported among governments is in place. Applying pension accounting guidelines for rating purposes that are materially different from GAAP may begin an undesirable trend of selective disregard of certain generally accepted accounting principles and substitution of rating specific criteria. This is problematic, even if well-intentioned, with the objective of enhancing comparability.

Specifically, the Commission is opposed to the adjustment, which proposes to substitute a common discount rate based on a high-grade long-term corporate bond index rate (5.5% for 2010 and 2011) to present value pension plan liabilities. The actuarial valuation of any pension plan inherently requires adoption of a series of assumptions that are appropriate for that specific plan. Substitution of common "assumptions" rather than tailored or plan appropriate assumptions is inconsistent with the intent of a plan actuarial valuation. We also have concerns that the index which is proposed for the discount rate is volatile. For 2012, the index used for discounting would have been much lower than what was used for 2010. The most recent value for July 2012 is 3.73%. In recent years, it has been as high as 8%. GASB considered and rejected using such volatile discount rates.

Further, the Commission is opposed to the proposed adjustment, which would similarly substitute a common amortization period for all plans. In essence, we believe these proposals, in the interest of enhancing comparability of pension obligations among state and local government entities, ignore the unique investment objectives and policies of the plans as well as each plan's status within its adopted amortization period. If adopted, these efforts would unfairly distort the funded status of the plans.

Also of concern is the likely confusion to result from multiple measures of a pension plan's funded status. GASB's most recent pension standards "delink" funding methodologies from financial reporting measures. Consequently, most plans will have two measures - amounts reported which are consistent with the adopted funding methodologies and amounts reported for financial reporting purposes. The GASB changes alone will create opportunities for confusion since such numbers will likely be substantially different. Adding a third set of values for rating agency purposes will likely result in further confusion and debate as to the appropriate measure of a pension plan's ability to meet its future benefit obligations. Governmental units may feel obligated to verify Moody's calculations by engaging their actuaries to perform additional work which will result in additional costs.

A final concern relates to the federal securities law disclosure requirements associated with the issuance of municipal bonds and the potential requirement for disclosure of this third set of pension numbers issued by an outside party. Since the Moody's sensitivity analysis would be in the public domain, despite the fact that a municipality had not commissioned the analysis, the municipality would need to determine whether all three measures of a pension plan's funding status needs to be disclosed in the municipality's Official Statements Disclosure counsel would need to review the applicability the Securities and Exchange Commission's anti-fraud Rule 10-b5. In addition, counsel would need to consider the San Diego Order (Section 5) wherein the SEC found that the City officials knew or were reckless in not knowing that the City's disclosures were false and misleading by failing to disclose in its Official Statement, the results of the Mayor's Blue Ribbon Committee Report that put the City officials on notice of San Diego's growing pension liabilities and the NJ Order (Paragraphs 23 and 24) related to the state's failure to disclose in its Official Statement the existence of or findings from the Benefit Review Task Force Report commissioned by the state's Acting Governor. This securities law concern will be compounded further if other rating agencies adopt similar, but not the same, adjustments to reported pension data.

We do not object to the remaining two principal adjustments, which propose to (1) allocate a proportionate share of liabilities associated with participation in a cost-sharing pension plan, and (2) report asset values at fair value rather than smoothed market. These two proposals are consistent with GASB's recently issued pension standards. Nor do we object to Moody's treatment of pension liabilities as similar to debt as that is consistent with GASB's standards.

Sincerely,

Rosemary Booth Gallogly

Rosemary Booth Gallogly
Chairperson, Local Pension Study Commission

cc: Governor Lincoln D. Chafee
Marcia Van Wagner, Moody's
Timothy Blake, Moody's
Robert Kurtter, Moody's
Naomi Richman, Moody's
Jack Dorer, Moody's
Alfred Medioli, Moody's
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