Pension and OPEB Study Commission
September 29, 2014
Minutes of the Meeting

A Study Commission meeting was held in the Senate Lounge of the State House, 82 Smith Street, Providence, Rhode Island on Monday, September 29, 2014.

Rosemary Booth Gallogly, Director of Revenue and Chairperson of the Pension and OPEB Study Commission called the meeting to order at 10:15 AM.

Commission members present: Rosemary Booth Gallogly, Jean Bouchard, Allan Fung, Steven Hartford, Dennis Hoyle, Antonio Pires, Melissa Malone representing Gina Raimondo, John Simmons and Steven St. Pierre

Members absent: Paul Doughty, J. Michael Lenihan, Joseph Polisena, Angel Taveras, and there is a vacancy due to the retirement of the Jamestown Town Administrator.

Others present: Susanne Greschner, Chief of the Division of Municipal Finance, Daniel Sherman, Actuary for the Pension and OPEB Study Commission and members of the public

Agenda Item #1 – Approval of Minutes from June 30, 2014

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 June 30, 2014. There were none. Mayor Fung, from the City of Cranston made a motion to accept the minutes as written. The motion was seconded by Antonio Pires, Director of Administration from the City of Pawtucket. The motion passed all in favor, except for Mr. Hartford, Director of the Department of Administration who abstained from voting.

Agenda Item #2 – Recommendations to General Assembly–continued discussion – Attachment B

Next on the agenda, the Chair referred to Attachment B, the recommendations that the Commission could present to the Governor and General Assembly. She indicated that the goal is to have recommendations adopted at the next meeting and then be presented to the General Assembly in the next session. The recommendations report includes findings, a summary of the recommendations considered, and it briefly identifies why each recommendation was made. The Chair thought that it was important to clearly identify whether or not there was consensus to each recommendation, and if there were any dissenting opinions as well. She said there would be an additional opportunity for the Commission to weight in during the legislative process. Any suggestions from the Commission members pertaining to the format or creation of the recommendations would be welcomed by the Chair.

The Chair then referred to a newly identified recommendation - item #10 that would require an annual funding notice. She explained that this was a byproduct from previous discussions and from some of the work she had done in the distressed municipalities on pension funding when concessions were part of a funding improvement plan (FIP) or a general workout of the distressed municipality’s finances.

The Chair explained that the annual funding notice template identifies key information about a local pension plan – information such as funding, valuation of the assets, liabilities and the funded ratio with a trend. This would include actuarially determined contribution, the percentage funded, and the money rate of return under the GASB standards. This standard would show the rate of return in a prescribed manner so that everyone's numbers would be apples to apples. It is important, she believes, to inform stakeholders where they could obtain resources on updated information about the health of their pension plan. The Chair referred to a sample of the annual funding notice that was prepared for the City of Pawtucket's police and firefighters pension plan. The proposed funding notice would be sent to plan members on an annual basis, and could then be provided on both the municipality's and Division of Municipal Finance's websites.

The Chair suggested that this recommendation be considered, and thought that it would continue to draw attention to the pension issues. Mr. Pires explained that the City of Pawtucket had instituted a policy that if the annual required contribution (ARC) was not funded at 95%, then notice would be sent to both the retirees and active members informing them of such and then the city council would be required to hold a public hearing. Furthermore, the concept of a public notice provision provides for a comfort zone that is open and transparent, and he would support it. The Chair said that the first issue could be the cost associated with providing the notice to its members, and the second issue would be the time involved for the preparation of the annual funding notice – both might be considered unfunded mandates. Dan Sherman, Actuary for the Pension and OPEB Study Commission indicated that the time requirement for preparation of the notice would not require a huge amount of time. The postage expense could be resolved by the use of electronic notification or by including notification with a member's check. Melissa Malone, representing Gina Raimondo agreed with the notification recommendation and pointed out that the added expense would be a limited time period for the municipalities as more and more people become comfortable using electronics. However, Mayor Fung thought it would not be a limited time period since most of the retirees are of an older population and those notifications would still need to be mailed out, which could be a funding challenge for the municipalities.

The Chair said another important issue that should be considered in the recommendations report is whether or not an actuary made a recommendation that was not followed by the municipality. She indicated that the language could be obtained in the Retirement Security Act, and that similar language could be used for this recommendation. Jean Bouchard, municipal vice president of AFSCME, Council 94 agreed that notification should be shared with retired and active members. However, although Mayor Fung agrees, he cautioned that this should be a sample notification so that the community has the flexibly to determine its own language and provide the contact information as they see fit since it could generate concerns/questions. Steven St. Pierre, sergeant of the Bristol Police Department, agreed that getting the information out is a phenomenal idea and getting the response back is the desired prompt, but he believes that there needs to be flexibility for the individual municipality to indicate where that information comes from. John Simmons, executive director for the R.I. Public Expenditure Council's concern is if there would be any consequences if a municipality failed to notify all (100%) of its members. He agreed with submission of the notice; however he thought that there could be challenges if all of the members had not received the information. The Chair indicated that there would be no consequences, that it is an attempt for transparency and to give the members of the pension systems the information that they need to know in order to be informed stakeholders.

The Chair thought that perhaps language could be included that states "this is provided for informational purposes" and also to include language that states that it is the responsibility of the member to provide the system with their current address and other pertinent legal information.

The Chair asked the Commission members to review the recommendations in order to be certain that the Division's staff had in fact expressed all of their concerns. She also asked the Commission if they had any comments on how the report could be brought forward since it would be a report that comes from the board. The Chair's goals are to try to get an appointment with the legislative leadership to discuss the work of the Commission, send out a draft of the recommendations prior to the next meeting in order to give the members the opportunity to review them further, and to adopt the recommendations at the next meeting. Due to the complexity of the recommendations, Mr. Pires suggested that there be a series of meetings with the General Assembly.

Referring to item #1 – membership of the oversight board, Mr. Simmons asked why the current membership of the Commission should be altered on a go-forward basis. The Chair replied that a smaller oversight board would be more nimble; however ultimately that would be the General Assembly's decision.

Mr. St. Pierre had one criticism and that is that he had many dissenting or opposing opinions that he felt were portrayed as less valued than the way they came across in the written recommendations. Specifically, he mentioned the authority and powers of an oversight board; there were issues that he might have concerns about based on the make-up of the oversight body. Therefore, whatever the membership of the oversight body may be comprised of would then dictate the powers they should have. He stated that a public hearing may be a fine vehicle, but if certain interests are not presented in that group then he doesn't believe that a public hearing suffices. Furthermore, he doesn't know how comprehensively he can voice his opinion of some of the issues since the make-up of the oversight body is unknown. The Chair indicated that the recommendations would need to be reviewed once the composition and the authority of the board are determined. She said if there are issues that need to be made stronger in regard to any of the commission member's dissenting positions or ideas to please let her know. Mr. Pires commented that he believes that it is important to have a balanced perspective from all the commission member's points of view in the final report so the General Assembly is fully aware of the issues and concerns. Ms. Malone thought that it was also important for the General Assembly to understand which ideas and recommendations are the existing obligations that the fiduciaries have to the plans, so that it is not interpreted as additional items that the cities and towns have to perform. Furthermore, Ms. Malone thought that many of the recommendations are "best practices" and would fall under the umbrella of what they should be doing in the normal course. Therefore, she believes that the commission should differentiate that so that it is clear as to what the fiduciary responsibility is of the local pension boards and then what is the additional requirement that is being considered in the recommendations. The Chair indicated that a front section of the report is being worked on to include this information, and a draft would be sent to the Commission. The Chair suggested that Mr. Sherman review the GFOA best practices. Mayor Fung said that it is unfair to look at a smaller pension plan and to compare the results with the Municipal Employees Retirement Systems (MERS) type investment guidelines. Mr. St. Pierre agreed. Mr. Simmons inquired about the authority of the assumptions, and if the board does not approve them, does it relieve them of their responsibility if the ARC was not made. The Chair said there are many responsibilities of the municipalities, and unless there is someone to make sure that it is focused on, it would fall off the table. Mr. St. Pierre said that if the municipalities are using assumptions that are not going to encourage stability in their plans, then there should be some vehicle for the oversight body that holds the municipality accountable to that. Therefore, he believes that there should be standards as to what those assumptions should be or the criteria that the municipality needs to follow versus a lot of other things that are more contemptuous. Mr. Simmons agreed, and said that if the assumptions are not met, then the unfunded liability would increase and the amount to be funded would increase, therefore it would be self-correcting. However, Ms. Malone said that assumes that when the unfunded liability increases that it is paid, which if it is not paid could be a problem. Ms. Malone agreed that there needs to be some consequences since the variables could be manipulated. The Chair said that the experience studies should reveal if the assumptions need to be updated. It would be important to include with the funding notice that if there is an experience study that was done, and the actuary recommends some changes that the municipality does not adopt, then the unfunded liability would not be correct. Both Mr. St. Pierre and Mr. Simmons agreed. Dennis Hoyle, Auditor General asked if it would make sense, in certain cases, for the oversight body to make a recommendation as to certain actuarial assumptions, that would not be binding. Mr. Sherman explained that the two most critical issues for the health of the pension plans are funding of the ARC and the proper set up of the investments. He said that the actuarial assumptions affect the timing of the money going in and have an impact of shifting dollars from one time period to another, but that funding of the ARC and investment returns are what make a plan well-funded. Mr. Pires said that he has been advocating for a very strong regulatory body to strengthen the system.

The Chair referred to item #2 that is to expand legislation requiring fiscal impact statements. Mr. St. Pierre asked for the definition for the cost of the preparation of the estimate. He thought that the cost could be expensive, and that since it would be mandated that cost assistance should be provided to the municipality. Mayor Fung agreed that the cost could be an issue, and he thought that an actuary would be needed throughout the negotiation process to determine the actual impact to the municipality. Furthermore, he said there is no uniformity among the municipalities as to what should or should not be in a fiscal note. Ms. Malone suggested minimizing the cost of the preparation of the estimate, so that it is timed appropriately for both the pension and OPEB plan changes. The Chair envisions a broader fiscal impact statement that would include the unfunded liability and a twenty-year schedule, and the impact to the community. Mr. Hartford said that it is a problem to not understand the implications of the decisions that are being made. There was consensus amongst the Commission on the concept, but the question was who would incur the cost. The Chair indicated that she would include “or other changes” as it relates to the collective bargaining for fiscal impact statements, and provide stronger language for the state and clarification of the cost associated with the preparation of the estimate.

Item #3 – Continue Funding Municipal Incentive Aid Program, the Chair confirmed that the Commission was in agreement to this recommendation.

Item #4 – Administer a Voluntary Program to Invest Plan Assets through the State Investment Commission, the Commission was somewhat in agreement provided that it was on a voluntary basis. The Chair indicated that this would be work that would be provided by the treasurer’s office if that were to occur. Ms. Malone said that there may be cost savings because of the volume of assets would provide for increased efficiencies and investing; however the difficulty of this would be that various communities have different funding levels and/or non-existing funding levels, and attempting to properly allocate the investments to match that. While the State Investment Commission oversees the investment allocation on the State’s side, Ms. Malone thought that this may require more detailed analysis and resources due to the complexity related to the other post-employment benefits (OPEB). The Auditor General said there is an existing infrastructure that is in place that could probably accomplish this in an easier way, particularly as it relates to negative cash flow plans that are invested. The Chair indicated that the Commission would study this recommendation further.

Item #5 – Expand Criteria for Oversight under the Fiscal Stability Act, if a municipality meets two out of five criteria, they could be considered for state oversight. It is proposed that critical status be added as additional criteria so that there would be two out of six items which might trigger state oversight. Mr. St. Pierre formally dissented. Mr. Simmons thought that the oversight methodology should be used when a community is not making their ARC payments and will become in critical status. Mr. St. Pierre said that if a community's pension is in such disarray, the other criteria will be met. He felt it was unnecessary to further vilify the local pensions. Mayor Fung suggested changing the recommendation so that if a community's plan was in critical status, but is on a pathway following a funding improvement plan it would not be a factor counting against a municipality. As an example, Cranston's local plan is in critical status and it will take a long time to get out but Cranston is following its funding improvement plan. The Chair agreed with the Mayor's point of view.

Item #6 - Develop a Voluntary MERS Pathway, the Chair indicated that this is complicated since there are a lot of differences where plans might be compared to what they would be if they came under MERS, and getting those benefits synchronized would be a significant lift. However, she said if there was a way where there was a desire from the members, city/town council, mayor/manager's perspective, it would be a good thing if it were made available. Ms. Malone indicated that one of the issues would be with closed plans that are not adequately funded. She thinks that the voluntary pathway to MERS works best with the combination of the active members and retirees so that there is a stream of money coming in to pay for it. Due to the complexity of this recommendation, the Chair said it warrants further study. Mr. St. Pierre agreed, and asked that there be a more complete dissertation of the opposing view provided in the recommendation. The Chair said further study will be included in the recommendation, particularly the instability that might be created if a closed plan is brought into MERS because eventually it will consist only of retirees.

The Chair referred to the changes in the GASB accounting standards where one of the benefits for MERS plans is that, the auditor general and retirement system staff are working together to provide the necessary disclosure that communities will need for their financial statements because it is a significant change that is required. The communities that have locally-administered plans have that responsibility as well for the fiscal year that just ended. For locally-administered plan, the information is not being provided in a nice neat package, so communities will need to talk to their actuaries and investment advisors. Due to the new investment return calculation it is a lot more work for the local plans.

Items #7, 8 and 9 – Continue to Monitor OPEB Plans, Consider Funding Improvement Plans for OPEB and Establish a State-wide OPEB Trust – the Chair said that further study needs to be conducted that would provide assistance to the communities to get a handle on the OPEB. If funding improvement plans were done for OPEB, it would have to be significantly different than the ones done for the pension plans. She referred to the possibility of establishing a Statewide OPEB Trust and said that if there is going to be an extension of the shared services concept then now is the time to be researching this approach. Mr. St. Pierre suggested that perhaps the communities that already have an OPEB Trust, and have shown success could be highlighted.

The Chair said that if there were any issues that the Commission members would like her to include or rework the way an issue is presented, in order to provide a more balanced view, she would very much appreciate it if members would let her know. Mr. St. Pierre commented to the Chair and her staff commending them for a comprehensive recommendation report. Even though he disagreed with some of the flavor of it, the report was comprehensive and the Chair acknowledged they did a great job. The Chair also thanked Dan Sherman and Dennis Hoyle for their continued assistance.

Agenda Item #3 – Public comments

Peder Schaefer, Associate Director from the Rhode Island League of Cities and Towns, referred to the annual budget disclosure process for the municipalities, and he suggested that a community disclose whether they had funded their ARC for their pension contributions. Therefore, it would be transparent to the taxpayers, labor officials, and it would also give the Division of Municipal Finance a heads up if there is a problem. He suggested the disclosure would apply only to the pension plans, not OPEB. This discloses what is in the budget, 10 days before the public hearing, giving people the opportunity to voice their concerns in the public hearing process. Mr. Pires said it's another form of notice, but he not sure how effective that will be to all. Mayor Fung said it was adding another line to the notice on an important issue, such as pensions.

Agenda Item #4 - Adjourn

Mayor Fung made a motion to adjourn which was seconded Mr. Pires. The meeting adjourned at 12:02 PM.

Rosemary Booth Gallogly
Chairperson

October 27, 2014
Date

PSC/sm

Addendum to the September 29, 2014 OPEB and Pension Study Commission Meeting Minutes

Attachment B

[As of September 26, 2014]

Recommendations to the Governor and General Assembly

Local Pension & OPEB Study Commission

[Working Document]

[Draft]

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, and testimony related to actual implementation of improvement plans. Each year, new valuation reports are received by the Division of Municipal Finance (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, not yet in critical status, have funded ratios which are declining.

Recommendations Considered

The Commission has considered nine 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. Continue funding municipal incentive aid program
4. Administer a voluntary program to invest plan assets
5. Expand criteria for oversight under the fiscal stability act
6. Develop a voluntary MERS pathway
7. Consider funding improvement plans for OPEB
8. Continue to monitor OPEB plans
9. Establish 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 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 other area oversight bodies, the Division of Municipal Finance proposed the following structure:

- Director of revenue or designee
- Auditor general or designee
- Executive Director of State Retirement Board

- Two independent public members with expertise in finance, investments, accounting or actuarial expertise to be selected by the other members of the Oversight Board from a list of names provided by the Rhode Island Public Expenditure Council

The Commission discussed other possible board members:

- Local mayors or managers
- Police, fire and municipal representatives – both active and retiree representation
- League of Cities & Towns
- Representative designated by the League
- Treasurer's office

As part of the Division of Municipal Finance's 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.

PERAC consists of seven members. The Governor appoints three members:

- the Governor or his designee
- a representative of a public safety union
- an expert in the investment of funds

The State Auditor appoints three members:

- the Auditor or her designee
- the President of the Massachusetts AFL-CIO or his designee
- a representative of the Massachusetts Municipal Association

A seventh member of PERAC is appointed by the other six members and serves as Chairman. An executive director, selected by the Commission, plans, directs, coordinates, and executes administrative functions in conformity with the policies and directives of the Commission. Nearly all contributory retirement boards for public employees in Massachusetts consist of five members. PERAC oversees 106 retirement boards with over 500,000 members.

There was no consensus reached on the composition of the oversight body as initially drafted. Commissioners expressed the concern that the originally proposed board 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.

It was suggested by one commission member that the General Assembly be provided with a summary of the concerns and the recommended composition by DMF in a broad manner so that any recommendation can 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.

The composition of the oversight body, as drafted by the Division of Municipal Finance (DMF), was designed to be apolitical and the scope of its duties would be determined by engaging interested parties in a public hearing process. 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.

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 that would set the parameters for the work of the Oversight Board. The regulations 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.
- 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.
- 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 best practice guidelines for funding defined benefit pensions.[1]

[1] See appendix for the full GFOA guideline.

- 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, approve, or disapprove funding improvement plan submissions for those plans in critical status.
- The ability to withhold state aid if:
    a. there are two consecutive years of not paying at least 95% of the actuarially determined contribution
    b. increases in benefits are granted when the plan is in critical status
    c. failure to take actions required in final FIP or failure to submit a FIP
- 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.
- 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 modification of actuarial assumptions and methodology used in the valuation to ensure compliance with reasonable actuarial standards and best practices.
- 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.

The Division of Municipal Finance 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.

- 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.

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. Other members responded that many of the requirements were over-reaching and gave the state too much control over local issues. Changing certain items to "voluntary" provided some measure of support.

2 | Expand Legislation Requiring Fiscal Impact Statement

Amend RIGLs §44-35-10, §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 effecting pension and OPEB items, prior to entering into them, if there is a material change.

There was discussion about whether this recommendation was an unfunded mandate. Some commissioners thought that seed money for the first year of implementation would be appropriate and this should be considered. Others on the commission stated that municipalities should know the full cost for benefits prior to adopting any change as it is a good management practice. Dan Sherman, the commission's actuary, stated that this is not necessarily a huge cost and the actuary can help in this process. State law requires an actuarial valuation be prepared prior to action on any changes to state-administered pensions.

3 | 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.

4 | Administer a Voluntary Program to Invest Plan Assets

Require the State Investment Commission to 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.

5 | Expand 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. It is proposed that critical status be added as an additional event so that there would be two out of six items which might trigger state oversight.

6 | 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
- Provide for state/school aid offset in the event of failure to make required funding payments

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.

7 | Continue to Monitor OPEB Plans

The Commission recommends regular submission of OPEB valuations to DMF, 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 local 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. What does this mean? 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.

8 | 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.

9 | Establish 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. Commission members acknowledged that administering benefits would be burdensome and indicated they could recommend this as long as local control over benefit and cost structure is retained. The pooled investments would maximize returns and help to reduce risk. Some commission members felt that specifying a minimum number of municipalities volunteering to participate was necessary in order to create the structure. Again, economies of scale would bring benefits to small plans and reduce inefficiencies in the existing approach.

[Note: In addition to the above referenced nine recommendations which have been discussed with the Commission, an additional recommendation for consideration is added, which has not been discussed with the Commission at this point. It is the requirement that an annual funding notice be filed, see recommendation 10.]

10 | 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 feel 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.

Therefore, require 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.

Conclusion

The Commission is hopeful that the recommendations and comments contained in it 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 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

ANNUAL FUNDING NOTICE
For
[*insert name of pension plan*]

Introduction

This notice includes important information about the funding status of your pension plan ("the Plan"), as well as other information such as participant information and funding and investment policies. All locally-administered pension plans must provide this notice every year regardless of their funded status. This notice is provided for informational purposes and you are not required to respond in any way. This notice is for the plan year beginning [*insert beginning date*] and ending [*insert ending date*] ("Plan Year").

How Well Funded Is Your Plan

[Under Rhode Island law], the plan must report how well it is funded by using a measure called the "funded ratio." This percentage is obtained by dividing the Plan's Assets by Plan Liabilities on the Valuation Date for the plan year. In general, the higher the percentage, the better funded the plan. Your Plan's funded ratio percentage for the Plan Year and each of the two preceding plan years is shown in the chart below, along with a statement of the value of the Plan's assets and liabilities for the same period. In addition, the required funding payment and the planned contribution for the plan year, as well as the required funded payment and actual payments for the two preceding plan years are shown, along with the funded percentage for each year.

Summary of Key Valuation, Funding and Investment Data

		[Insert plan year- most recent]	**year - preceding year]**	**[Insert plan year - 2 years preceding]**
1	Valuation date	[xx/xx/xx]	[xx/xx/xx]	[xx/xx/xx]
2	Plan assets	[amount]	[amount]	[amount]
3	Plan liabilities	[amount]	[amount]	[amount]
4	Funded ratio	[=line1/line2]	[=line1/line2]	[=line1/line2]
5	Actuarially determined contributioı	[amount]	[amount]	[amount]
6a.	Funding from general fund	[amount]	[amount]	[amount]
6b.	Funding from non-general fund	[amount]	[amount]	[amount]
6	Total funding	[amount]	[amount]	[amount]
7	Planned/actual payment	[amount]	[amount]	[amount]
8	Percentage contributed	[line7/line 5]	[line7/line 5]	[line7/line 5]
9	Money weighted rate of return	[percentage]	[percentage]	[percentage]

Summary of Key Values

Plan Assets and Plan Liabilities, Contributions and Rate of Return

Total Plan Assets is the value of the Plan's assets on the Valuation Date (see line 2 in the chart above). Plan Liabilities shown in line 3 of the chart above is the amount the Plan needs on the Valuation Date to pay for promised benefits under the plan. The actual contribution and money weighted return on investments in accordance with GASB 67 are also shown.

Participant Information

The total number of participants in the Plan as of the Plan's valuation date was [*insert number*]. Of this number, [*insert number*] were active participants, [*insert number*] were retired or separated from service and receiving benefits, and [*insert number*] were retired or separated from service and entitled to future benefits.

Funding & Investment Policies

Every pension plan must have a procedure for establishing a funding policy to carry out plan objectives. A funding policy relates to the level of assets needed to pay for promised benefits. The funding policy of the Plan is [*insert a summary statement of the Plan's funding policy*].

Once money is contributed to the Plan, the money is invested by plan officials, called fiduciaries, who make specific investments in accordance with the Plan's investment policy. Generally speaking, an investment policy is a written statement that provides the fiduciaries who are responsible for plan investments with guidelines or general instructions concerning investment management decisions. The investment policy of the Plan is [*insert a summary statement of the Plan's investment policy*].

Under the Plan's investment policy, the Plan's assets were allocated among the following categories of investments, as of the end of the Plan Year. These allocations are percentages of total assets:

Asset Allocation	Percentage
1. Cash (interest bearing and non-interest bearing)	______________
2. U. S. Government securities	______________
3. Specify	______________
4. Specify	______________

For information about the plan's investment in any of the following types of investments as described in the chart above –contact [*insert the name, telephone number, email address or mailing address of the designated municipal representative*].

Events Having a Material Effect on Assets or Liabilities

[State law] requires the plan administrator to provide in this notice a written explanation of events, taking effect in the current or future plan years, which are expected to have a material effect on plan liabilities or assets. Material effect events are occurrences that tend to have a significant impact on a plan's funding condition. For example, changes made to the actuarial assumptions should be included as well as events expected to increase or decrease total plan assets or plan liabilities by five percent or more. For the plan year beginning on [*insert the first day of the current plan year (i.e., the year after the notice year)*] and ending on [*insert the last day of the current plan year*], the following events are expected to have such an effect: [*insert explanation of any plan amendment, scheduled benefit increase or reduction, or other known event taking effect in the current plan year and having a material effect on plan liabilities or assets for the year, as well as a projection to the end of the current plan year of the effect of the amendment, scheduled increase or reduction, or event on plan liabilities*].

Right to Request a Copy of the Annual Report

A plan sponsor is required to file valuation and experience reports for the plan. Copies of the reports are available from the Department of Revenue, Division of Municipal Finance (DMF), One Capitol Hill, Providence, RI 02903, or by visiting the DMF website at www.municipalfinance.ri.gov. For 2012 and subsequent plan years, you may obtain an electronic copy of the plan's valuation report by going to this website or you may obtain a copy by making a written request to the plan administrator. [*If the Plan's annual report is available on an Intranet website maintained by the plan sponsor (or plan administrator on behalf of the plan sponsor), modify the preceding sentence to include a statement that the annual report also may be obtained through that website and include the website address.*] Individual information, such as the amount of your accrued benefit under the plan, is not contained in the annual report. If you are seeking information regarding your benefits under the plan, contact the plan administrator identified below under "Where to Get More Information." Also, audited financial statements contain plan information in the footnotes and can be viewed on the DMF website link shown above.

Actuarial Information on File with the Division of Municipal Finance

Pursuant to R.I. General Laws §45-65-6 a plan sponsor must provide actuarial information about the plan under certain circumstances, such as when the funded percentage of the plan falls below 60 percent. The sponsor of the Plan, [*enter name of plan sponsor*], is subject to this requirement to provide plan actuarial information. The DMF uses this information for oversight and monitoring purposes.

Where to Get More Information

For more information about this notice, you may contact [*enter name of plan administrator*], at [*enter phone number and address and insert email address if appropriate*]. For more information about the DMF, go to DMF's website, www.municipalfinance.ri.gov. Note that audited financial statements will also provide additional information. Audited financial statements can be accessed on DMF's website.

BEST PRACTICE

Core Elements of a Pension Funding Policy (CORBA) (2013)

Background. The Government Finance Officers Association (GFOA) has recommended 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.1 To provide the desired degree of assurance, a pension funding policy would need to incorporate the following principles and objectives:

1. Every government employer that offers defined benefit pensions should obtain no less than biennially an actuarially determined contribution (ADC) to serve as the basis for its contributions;
2. The ADC should be calculated in a manner that fully funds the long-term costs of promised benefits, while balancing the goals of 1) keeping contributions relatively stable and 2) equitably allocating the costs over the employees' period of active service;
3. Every government employer that offers defined benefit pensions should make a commitment to fund the full amount of the ADC each period. (For some government employers, a reasonable transition period will be necessary before this objective can be accomplished);
4. Every government employer that offers defined benefit pensions should demonstrate accountability and transparency by communicating all of the information necessary for assessing the government's progress toward meeting its pension funding objectives.

These principles and objectives necessarily will affect decisions related to the treatment of three core elements of a comprehensive pension funding policy:

- Actuarial cost method - the technique used to allocate the total present value of future benefits over an employee's working career (normal cost/service cost).
- Asset smoothing method - the technique used to recognize gains or losses in pension assets over some period of time so as to reduce the effects of market volatility and stabilize contributions.

- Amortization policy - The length of time and the structure selected for increasing or decreasing contributions to systematically eliminate any unfunded actuarial accrued liability or surplus.

Recommendations. To ensure consistency with the principles and objectives described above, the GFOA recommends that a pension funding policy treat each of its core elements as follows:

Actuarial cost method. The actuarial cost method selected for funding purposes should conform to actuarial standards of practice and allocate normal costs over a period beginning no earlier than the date of employment and should not exceed the last assumed retirement age. Moreover, the selected actuarial cost method should be designed to fully fund the long-term costs of promised benefits, consistent with the objective of keeping contributions relatively stable and equitably allocating the costs over the employees' period of active service.2 While not the only method that would satisfy this criterion, the entry age method—level percentage of pay normal cost—is especially well suited to achieving this purpose.

Asset smoothing. The method used for asset smoothing should:

- Be unbiased relative to market. Thus, for example:
  - The same smoothing period should be used for both gains and losses, and
  - Market corridors (a range beyond which deviations are not smoothed), if used, should be symmetrical3, and
- Provide for smoothing to occur over fixed periods (the use of rolling periods normally should be avoided), ideally of five years or less, but never longer than ten years.
  - Provide for a market corridor if smoothing is to occur over a period longer than five years.

Amortization. Amortization of the unfunded actuarial accrued liability4 should:

- Use fixed (closed) periods that
  - Are selected so as to balance the twin goals of demographic matching (equitable allocation of cost among generations) and volatility management (funding at a level percentage of payroll) and
  - Never exceed 25 years, but ideally fall in the 15-20 year range;
- Use a layered approach for the various components to be amortized (that is, an approach that separately tracks the different components to be amortized); and emerge as a level percentage of member compensation or as a level dollar amount.

Additional considerations for plans closed to new entrants. When a plan is closed to new participants, the aggregate actuarial cost method – level percentage of pay normal cost – is especially well suited for funding.

For closed plans with no remaining active members:

- Special attention needs to be given to the mix of investments (given the shorter time horizon); and
- In comparison to open plans:
  - Asset smoothing periods should be shorter (typically no longer than three years);
    - Corridors, if used, should be narrower; and
  - Amortization periods should be shorter (typically no longer than 10 years for gains and losses).

For closed plans that still have active members:

- The continued use of level percent of member compensation amortization remains appropriate, but not for a long period (i.e., as the number of active members decreases); and
- In comparison to open plans:
  - Asset smoothing periods should be shorter;
    - For asset smoothing periods that exceed five years, a corridor (not to exceed 20 percent) should be used; and
  - Amortization periods should be shorter.

[1] "Guidelines for Funding Defined Benefit Pensions" (2013) (CORBA).

[2] Employers using some other actuarial cost method should carefully monitor demographic changes and trends in the covered workforce inasmuch as such changes could result in increased employer contributions as a percentage of payroll.

[3] Generally, the appropriate corridor will depend upon the length of the smoothing period, with longer smoothing periods requiring narrower corridors.

[4] Special considerations may apply to the amortization of a surplus (e.g., use of a longer amortization period).

Sample

ANNUAL FUNDING NOTICE
For
City of Pawtucket Police and Firefighters Pension Plan

Introduction

This notice includes important information about the funding status of your pension plan ("the Plan"), as well as other information such as participant information and funding and investment policies. All locally-administered pension plans must provide this notice every year regardless of their funded status. This notice is provided for informational purposes and you are not required to respond in any way. This notice is for the plan year beginning July 1, 2013 and ending June 30, 2014 ("Plan Year").

How Well Funded Is Your Plan

Under Rhode Island law, the plan must report how well it is funded by using a measure called the "funded ratio." This percentage is obtained by dividing the Plan's Assets by Plan Liabilities on the Valuation Date for the plan year. In general, the higher the percentage, the better funded the plan. Your Plan's funded ratio percentage for the Plan Year and each of the two preceding plan years is shown in the chart below, along with a statement of the value of the Plan's assets and liabilities for the same period. In addition, the required funding payment and the planned contribution for the plan year, as well as the required funded payment and actual payments for the two preceding plan years are shown, along with the funded percentage for each year.

	2014	2013	2012
1. Valuation Date	July 1, 2014	July 1, 2013	July 1, 2011
2. Plan Assets	97,220,726	82,981,582	73,435,524
3. Plan Liabilities	238,725,116	243,784,564	218,309,558
4. Funded Ratio	40.7%	34.0%	33.6%
5. Actuarial Determined Contribution	12,996,379	12,386,341	11,391,106
a. Amount from General Fund	12,996,379	12,386,341	11,391,106
b. Amount from Other Funds	0	0	0
6. Planned / Actual Payment	12,996,379	12,386,341	11,391,106
7. Percentage Funded	100%	100%	100%
8. Actual Return on Plan Assets	16.8%	10.9%	

Plan Assets and Plan Liabilities

Total Plan Assets is the value of the Plan's assets on the Valuation Date (see line 2 in the chart above. Plan Liabilities shown in line 3 of the chart above is the amount the Plan needs on the

Valuation Date to pay for promised benefits under the plan. The actual contribution and money weighted return on investments in accordance with GASB 67 are also shown.

Participant Information

The total number of participants in the Plan as of the Plan's valuation date was 668. Of this number, 285 were active participants, 383 were retired or separated from service and receiving benefits, and none were retired or separated from service and entitled to future benefits.

Funding & Investment Policies

Every pension plan must have a procedure for establishing a funding policy to carry out plan objectives. A funding policy relates to the level of assets needed to pay for promised benefits. The funding policy of the Plan is [*insert a summary statement of the Plan's funding policy*].

Once money is contributed to the Plan, the money is invested by plan officials, called fiduciaries, who make specific investments in accordance with the Plan's investment policy. Generally speaking, an investment policy is a written statement that provides the fiduciaries who are responsible for plan investments with guidelines or general instructions concerning investment management decisions. The investment policy of the Plan is [*insert a summary statement of the Plan's investment policy*].

Under the Plan's investment policy, the Plan's assets were allocated among the following categories of investments, as of the end of the Plan Year. These allocations are percentages of total assets:

Asset Allocations **Percentage**	
1. Cash (interest bearing and non-interest bearing)	4%
2. U.S. Government securities	23%
3. Equities	72%
4. Receivables	1%

For information about the plan's investment in any of the following types of investments as described in the chart above –contact [*insert the name, telephone number, email address or mailing address of the designated municipal representative*].

Events Having a Material Effect on Assets or Liabilities

State law requires the plan administrator to provide in this notice a written explanation of events, taking effect in the current or future plan years, which are expected to have a material effect on plan liabilities or assets. Material effect events are occurrences that tend to have a significant impact on a plan's funding condition. For example, changes made to the actuarial assumptions should be included as well as events expected to increase or decrease total plan assets or plan liabilities by five percent or more. For the plan year beginning on [*insert the first day of the current plan year (i.e., the year after the notice year)*] and ending on [*insert the last day of the current plan year*], the following events are expected to have such an effect: [*insert explanation of any plan amendment, scheduled benefit increase or reduction, or other known event taking effect in the current plan year and having a material effect on plan liabilities or assets for the year, as well as a projection to the end of the current plan year of the effect of the amendment, scheduled increase or reduction, or event on plan liabilities*].

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Actuarial Information on File with the Division of Municipal Finance

Pursuant to R.I. General Laws §45-65-6 a plan sponsor must provide actuarial information about the plan under certain circumstances, such as when the funded percentage of the plan falls below 60 percent. The sponsor of the Plan, City of Pawtucket, is subject to this requirement to provide plan actuarial information. The DMF uses this information for oversight and monitoring purposes.

Where to Get More Information

For more information about this notice, you may contact [*enter name of plan administrator and if applicable, principal administrative officer*], at [*enter phone number and address and insert email address if appropriate*]. For more information about the DMF, go to DMF's website, www.municipalfinance.ri.gov. Note that audited financial statements will also provide additional information. These can be accessed on DMF's website.