Pension and OPEB Study Commission
November 24, 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, November 24, 2014.

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

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

Members absent: J. Michael Lenihan, Joseph Polisena, John Simmons, 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, and members of the public

Agenda Item #1 – Approval of Minutes from October 27, 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 October 27, 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 Steven St. Pierre, sergeant of the Bristol Police Department. The motion passed all in favor.

Agenda Item #2 – Recommendations to General Assembly–for vote, Attachment B

Next on the agenda, the Chair referred to Attachment B, the recommendations relating to locally-administered plans for pensions and other post-employment benefits (OPEB) that the Commission is planning to present to the Governor and General Assembly. The Chair said that the recommendations report was prepared in fulfillment of the Commission's responsibilities under the Retirement Security Act. The Commission has been meeting for more than two years and their mission was to determine what could be done to ensure security for locally-administered pension and OPEB plans. The Commission has had many discussions pertaining to the recommendations and has made every effort to provide a balanced perspective. Antonio Pires, director of administration from the City of Pawtucket, thought it was important that the General Assembly be made aware of the dissenting opinions from the Commission members. The Chair hoped that the Commission members would still be involved in the next step once the General Assembly and the Governor-Elect determine what the best process would be.

Item #1 - recommendation is to establish an Oversight Board was discussed at the last Pension Study Commission meeting held on October 27, 2014.

Item #2 – recommendation is to expand legislation requiring fiscal impact statements. This would require a fiscal impact statement from an actuary, with a cost estimate, for collective bargaining changes affecting only pension and OPEB items, prior to entering into them. Mayor Fung asked for clarification as to what change would require the fiscal impact statement. The Chair said that it was a plan design change. She indicated that she would provide clarification for this recommendation.

Item #3 – recommendation is to require an annual funding notice. This recommendation would require that an annual funding notice be sent to the retirees and active members. The Chair said that it is important that each stakeholder feels that the information relating to their pension plan is transparent and available to them on a regular basis. A template of the annual funding notice would be included in the recommendations report. Mayor Fung inquired if it pertained to only the critical status plans or to all the locally administered plans. His concern was with the additional cost of providing notices to the plan members, and the potential questions that may arise from its members. However, the Mayor thought that if the notice was required, that it be comprehensible. The Chair suggested a detailed cover letter be included with the annual funding notice. Melissa Malone, representing Gina Raimondo suggested electronic notification, and pointed out that it would be for all of the plans. She believes that it is important to make people aware and put them on notice. Jean Bouchard, Municipal Vice President of Council AFSCME, Council 94 also agreed, and also felt that it was important that the notice be comprehensible. Ms. Malone indicated that the State notifications to its members are part of the administrative cost that is spread across all of the plans. Although a legal opinion should be obtained, the Chair thought as long as it was an expense for the benefit of the beneficiaries that is reasonable and not excessive. Mr. Pires commented that to require an annual funding notice is good sound business practice for the plan participants and the taxpayers. The Chair believes the notification is important to help keep the plans on track in the future.

Item #4 – recommendation is to expand proposed budget language in municipal disclosure process. Presently RIGL 44-35-7 requires that notice of the budget be provided in local newspapers. This recommendation would include a section to indicate whether or not the annual required contribution (ARC) had been funded at 100% and the funded status of the locally-administered pension plans.

Item #5 – recommendation is to continue funding municipal incentive aid program. The municipal incentive aid program was initiated in the 2014 budget, and it is funded in the 2015 budget. Initially, it was proposed as a three-year program. The program provided that a municipality only receive their municipal incentive aid if they had developed a funding improvement plan (FIP) that had been approved by the local governing body, and then in the next year had implemented it and have shown that they were funding the ARC in accordance with the FIP. The Chair said that providing this aid would be subject to the resources at the State level in regard to how much state aid would be granted. Presently there is $5 million in the state budget for this fiscal year.

Item #6 – recommendation is to administer a voluntary program to invest plan assets. The Commission thought that it would be helpful if the State Investment Commission was involved in investigating whether it could be possible for locally-administered plans to turn over either all or a portion of their assets for investments and then be able to achieve some of the economy of scale that the State Investment Commission achieves with the Municipal Employees Retirement Systems (MERS) -- where each plan is a separate trust, but they are able to be invested as part of the larger portfolio. The Commission thought that it is worth further study and that it could potentially be made available on a voluntary basis. Dennis Hoyle, State Auditor General, thought it would be a good program to offer to the municipalities who would be obtaining better information with GASB 67 in measuring performance. Ms. Bouchard agreed, but thought it should be voluntary. Mayor Fung inquired if a municipality were to go into MERS, would the responsibility be shared with the State. Ms. Malone said that was one of the legal issues because the investments would be on the State side, but on the administration of the plan would still be with the municipality. Furthermore, there could be an issue if there is a poorly funded plan where more liquidity would be needed. The Chair said that the legal structure would have to be looked at. She said that Daniel Sherman, Actuary for the Pension and OPEB Study Commission could be helpful in providing the knowledge of how it had been done in the State of Massachusetts. Mayor Fung suggested that the word "require" be eliminated from the recommendation since there could be some challenges. The Mayor suggested the recommendation language be changed to - have the State Investment Commission look at the potential of administering a program which invests assets. Mr. Pires said if the State were to make this permissible by investing the plan assets at the State level, then he would hope that the Statute included language that would clearly indicate that there would be no transfer of the fiduciary liability to the State. The Chair stated that the language would be modified to indicate that the State Investment Commission would continue to investigate and develop alternatives and to look at the legal side of them.

Item #7 – recommendation is to expand the criteria for oversight under the fiscal stability act. The Chair indicated that there is language under the Fiscal Stability Act that triggers the State to intervene and provide some oversight in troubled municipalities or fire districts; however, there is no language relating to pension funding. Presently, in order to be subject for state oversight, the municipality has to meet two of five criteria. In addition, based on further analysis the State would decide whether or not oversight is needed. Mr. Pires thought that if a municipality was already in critical status and then had to meet only one additional criteria seemed a bit harsh, and Mayor Fung agreed. However, the Chair indicated that assuming a municipality had adopted a funding improvement plan and was following it, then it possibly could be discounted as to how much weight that would put towards meeting that criteria. Mr. Pires thought it could be an issue. Mr. St. Pierre said that although he may disagree with the necessity of the recommendation, in order to move forward with the recommendations, he does not have a problem with the recommendation as written. The Chair then asked the Commission members how they would feel if there were three out of six criteria. Mr. St. Pierre said it unnecessarily vilifies pensions further. He thought that the working document that was presented to them at that meeting represents a fair balance of what the Commission had discussed.

Item #8 – recommendation is to develop a voluntary MERS Pathway. The Chair said that this recommendation indicates that it would be voluntary and that there would be additional work to facilitate that, both legally and by reviewing the individual plans. Mr. Hoyle thought that it should be kept open as an option. Mayor Fung asked for clarification of the last bullet point that states to provide for state/school aid offset in the event of failure to make required funding payments. The Chair said that the voluntary MERS pathway is to create protections for the other members of MERS, and to ensure that if a plan comes into MERS that it must abide by certain requirements that are unique to that particular plan. Therefore, she suggested that the last bullet point would be revised to read – to provide protection for existing MERS plans by incorporating protections in the entrance agreements for the new plans that voluntarily want to join MERS, that they may be subjective to higher standards than other MERS members.

Item #9 – recommendation is to continue to monitor OPEB Plans. The Chair said one of the things that her department could not recall was whether or not the Commission had agreed that the future oversight body, acting through Municipal Finance, would actually get and receive OPEB valuations on a regular basis. She said that it is not currently provided for in State law. However, she thought that if the oversight body is going to have the responsibility of OPEB that they should at least be receiving the data and that it should be a requirement. The submission would follow GASB requirement, generally biennially for plans with a total membership of 200 or more, triennially for plans with less than 200 total members. The Commission members were in agreement on this recommendation.

Item #10 – recommendation is to consider funding improvement plans for OPEB. The Chair indicated that the Commission had discussed having funding improvement plans for OPEB, however there was no consensus reached. This recommendation could be determined by the future oversight body. Ms. Malone suggested that the amount of the liability could be included in the recommendation. Although the liability table is included in recommendation #9, it should be also be included in this recommendation.

Item #11 – recommendation is to establish a state-wide trust. This recommendation relates to the establishment of a state-wide OPEB trust. The Chair indicated that there were not specific recommendations on how that could be done. This recommendation was worded to reflect further study was needed.

The Chair asked the Commission members if they had any reservations on the recommendations or if they could not support any one of them to please identify them to her. The Commission members then went through the recommendations listed below, and any comments or opposing views are noted.

1. Establish an oversight board

   Allison Rogers, representing Steven Hartford, Director of the Department of Administration, asked that the Commission consider including the Director of the Department of Administration (DOA) or his/her designee for the oversight board. Ms. Rogers believes that given the scope of OPEB, and the fact that the Director of DOA works on the OPEB for state employees, it makes sense to have some synergies there. The Chair agreed that the Director of DOA could be a valuable asset to have included in the oversight board. However, Mayor Fung thought that the oversight board should include either the Director of DOA or Director of the Department of Revenue (DOR), not both. Ms. Malone pointed out that the DOA and the DOR are not synonymous; therefore with regard to OPEB it would be beneficial to have the DOA designee. Mr. Hoyle agreed that having the DOA Director could be a good resource, especially when considering establishing a state-wide OPEB trust. The Chair took a vote from the Commission members to add the position of Director of the Department of Administration to the oversight board, five agreed and four disagreed. A narrative will be included in the recommendation explaining what the rationale is.

2. Expand legislation requiring fiscal impact statements

3. Require an annual funding notice

   Notice will be provided in the report

4. Expand proposed budget language in municipal disclosure process

5. Continue funding municipal incentive aide program

6. Study feasibility of administering a voluntary program to invest plan assets

7. Expand criteria for oversight under the fiscal stability act

   Mr. St. Pierre said that with the caveat that if the recommendation is to go forward with the way that it is written, then he would not have a problem with this recommendation. Mayor Fung noted that the Commission does not have consensus on this recommendation.

8. Develop a voluntary MERS pathway.

   The Chair asked if the Commission wanted to include language indicating to investigate further. Ms. Malone thought that the second paragraph of the recommendation was very clear.

9. Continue to monitor OPEB plans

10. Consider funding improvement plans for OPEB

11. Establish a state-wide OPEB trust

Mayor Fung suggested moving a comment that he had made from the last paragraph (in red) under the "challenge section" on page 6 of Attachment B to a bullet point on page 14 as another concept . The Commission agreed on moving the paragraph, and to indicate that legislation might be developed with input from the Commission. .

The Chair stated that there were eleven recommendations made by the Commission for the General Assembly to consider, some of which are definitive actions and others are areas where the Commission believes work needs to be continued and further study is needed. She informed the Commission that they may be called upon to weigh in on the recommendations.

The Chair then asked for a motion to approve the eleven recommendations as written, with the modifications that they had just discussed. Paul Doughty, President of the Providence Firefighters' Union Local 799, made a motion to adopt the recommendations. The motion was seconded by Ms. Bouchard. The motion passed all in favor.

Agenda Item #3 – Next steps

The Chair informed the Commission that the final recommendations report that would include the modifications and the updated funding tables would be mailed to them. She plans to meet with the Governor-Elect and the General Assembly leadership to discuss the documents, and if there are any issues that need clarification, the Commission members may be called upon.

The Chair explained that there are two things that she envisions, actions be taken on the recommendations and legislation to implement them. But, at a minimum she believes there needs to be legislation to address what the on-going role of the Pension Study Commission will be. The Statute was part of the Retirement Security Act. The Pension Study Commission is responsible for receiving the annual valuations and the experience studies every three years, and is also responsible for receiving the funding improvement plans that are required for any municipality that falls below being 60% funded. Therefore, she said that is something that will continue to happen unless there is a board to replace the Study Commission. The Chair was not certain if there would be another meeting. Mayor Fung thanked the Department of Revenue staff, Daniel Sherman, Actuary for the Pension and OPEB Study Commission, and all the actuaries that had presented at their meetings. The Chair concluded by thanking all of the Commission members and her staff for their service.

Agenda Item #4 – Public comments

A public comment was received from Peder Schaefer, Associate Director from the R.I. League of Cities and Towns.

Agenda Item #5 – Adjourn

Mr. Doughty made a motion to adjourn which was seconded Mr. Pires. The meeting adjourned at 11:45 AM.

_______________________________________ ______________________________

Chairperson Date

PSC/sm

Addendum to the November 24, 2014 OPEB and Pension Study Commission Meeting Minutes

Attachment B

[AS OF NOVEMBER 20, 2014]

Recommendations to the Governor and General Assembly

Local Pension & OPEB Study Commission

[Working Document]

[DRAFT]

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Commission Members

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

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

Executive Summary

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

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

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

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

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

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

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

As part of our review~~, 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. Our many discussions revealed that the Commission was not in favor of centralized oversight like PERAC, particularly in terms of plan administration and approval authority. See appendix for PERAC structure.

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

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

The Crisis

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

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

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

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

Our Challenge

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

> *"The Commission shall review existing legislation and pension plan administrative practices and to make recommendations for the improved security and funding of locally-administered plans and other post-retirement benefit obligations of cities and towns."*
> *(RIGL §45-65)*

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

Guiding Principles

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

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

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

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

Strategies and Accomplishments

Raising awareness and increasing access to information

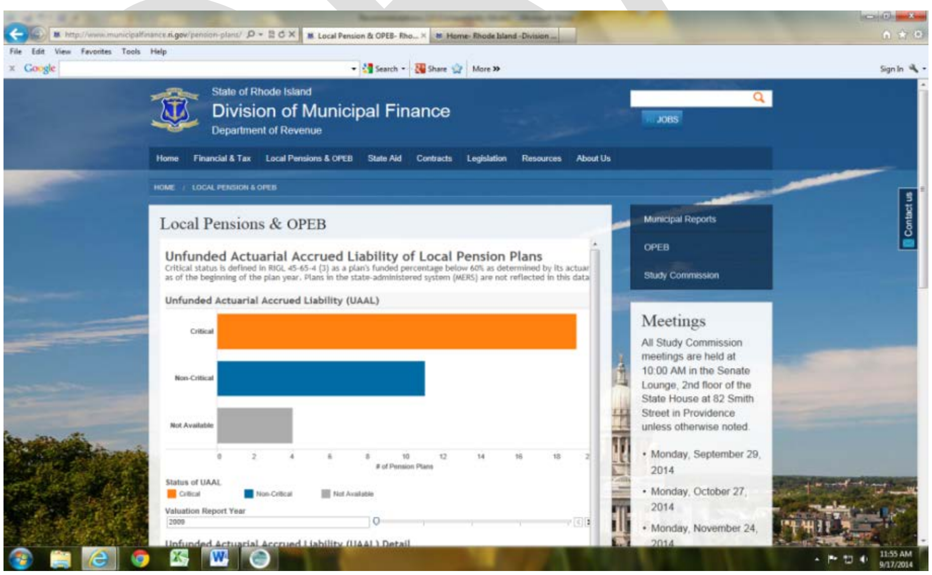
It was important to ensure that stakeholders were aware of the extensive data collected by the Commission and the importance of this information for effective decision-making. This was fundamental to our process. Commission members at one time or another all voiced the sentiment that it is important to have current, relevant data to make informed decisions. The Commission has included an appendix, divided into three parts—part one is supplementary information included specifically for reference to the recommendations; part two includes general pension information such as our recent outreach to all critical status plans highlighting FIP implementation progress and ARC payments planned, paid, and budgeted; part three contains information related to OPEB such as survey results and an important analysis of data based on OPEB valuation reports received through November 2013.

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

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

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

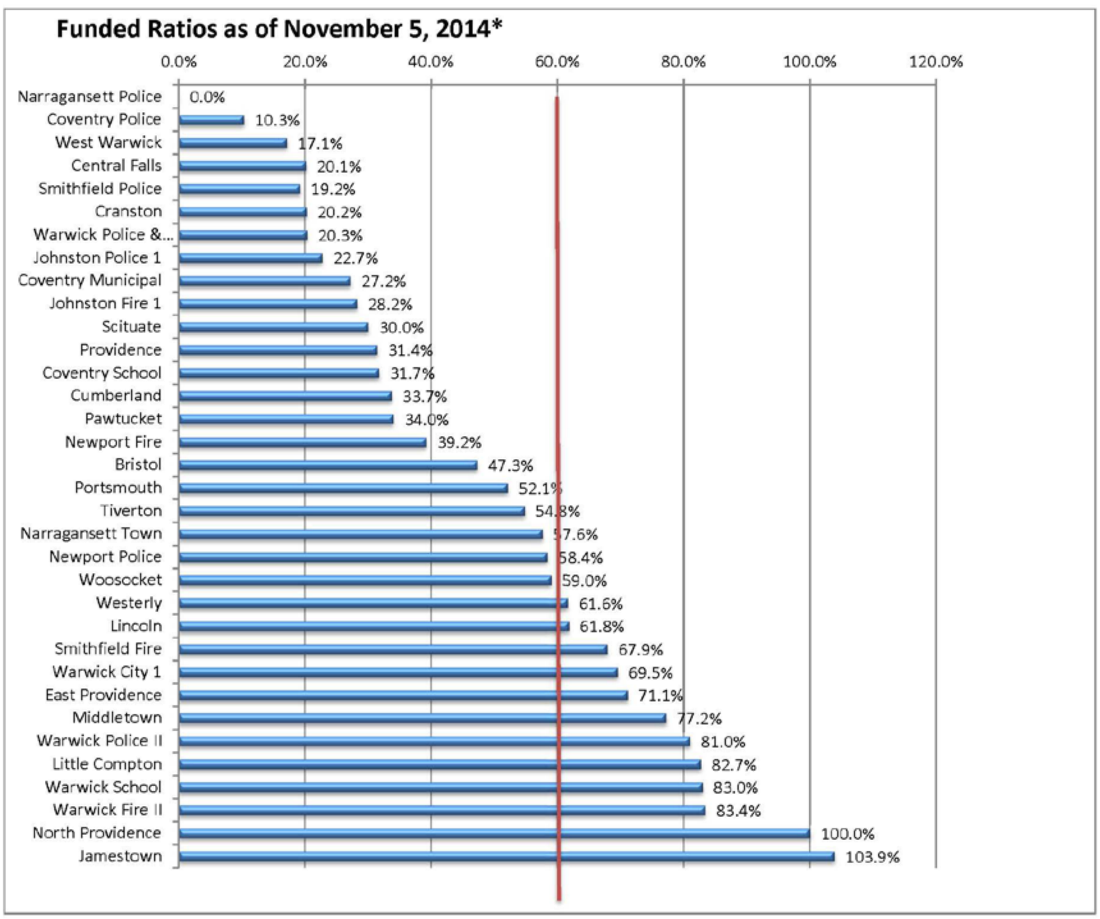
Accurate and detailed minutes of all commission meeting are available on the DMF website. The Division of Municipal Finance has an entire section devoted to pension and OPEB valuations, experience studies and funding improvement plans. DMF assisted the Commission to make it easy for stakeholders—mayors,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



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

Developing shared goals

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



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

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

Delivering training

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

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

Finding

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

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

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

Recommendations Considered

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

1. Establish an oversight board
2. Expand legislation requiring fiscal impact statements
3. Require an annual funding notice
4. Expand proposed budget language in municipal disclosure process
5. Continue funding municipal incentive aid program
6. Administer a voluntary program to invest plan assets
7. Expand criteria for oversight under the fiscal stability act
8. Develop a voluntary MERS pathway
9. Consider funding improvement plans for OPEB
10. Continue to monitor OPEB plans
11. 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 that local plans follow the best practices of actuaries and government financial standards.

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

- ~~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~~

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

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

[moved to page 5. ~~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.~~]

[this section below is MOVED TO APPENDIX]
[~~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~~ any proposed board that was not balanced in representation may dictate to the municipalities and/or labor without consideration of the interests of these groups. The commission members were conflicted in determining the composition of a group of impartial oversight board members. Mayors and union representatives had concerns about an oversight body without representation from their groups. Some commission members cited a need for representation of active and retired plan members. Other members expressed the concern that impartiality may be difficult for a sitting mayor/ town manager to take a position contrary to another mayor's/town manager's funding improvement plan.

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

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

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

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

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

Since this is a transition period, municipalities will need to bolster their funding policy.

- 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 to determine whether the FIP meets the established guidelines.
- Recommend ~~The ability to~~ withholding non-education state aid if:
    a. there are two consecutive years of not paying at least 95% of the actuarially determined contribution for pension plans in each year
    b. increases in benefits which create an increase in the unfunded liability, are granted when the plan is in critical status
    c. failure to take actions required in final FIP or failure to submit a FIP

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

  While some Commission members questioned whether MERS was the appropriate plan to measure against, the Commission's consulting actuary stated that local plans generally use the state plan as a benchmark. Any wide variation of plan performance (more than 200 basis points) must be viewed in the context of whether or not the plan is closed (where members are retirees only and no active employees entering the plan). These plans should be viewed differently due to asset allocation and stream of income.
- Advocate for sufficient resources to fund the activities of the Division of Municipal Finance in support of the board's responsibilities as part of the annual budget process.
- Power to question and require ~~modification of~~ the plan's actuary to make a presentation on the 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 concepts developed for the authority and powers of the oversight board also met with considerable discussion, particularly as they relate to the withholding of state aid and adoption of a funding policy which must be approved by an oversight body. The auditor general and director of revenue both agreed that some enforcement powers were necessary for steering plans on the path to sustainability. Without enforcement measures there would be slow or little progress other than a process of public shaming. However, as has been stated before, no consensus was reached on withholding state aid.

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

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

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

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

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

2 | Expand Legislation Requiring Fiscal Impact Statement

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

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

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

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

3 | Require an Annual Funding Notice

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

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

status. Ongoing communication to plan members is important for all local plans, and is a best practice adopted by the private sector.

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

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

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

4 | Expand Proposed Budget Language in Municipal Disclosure Process

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

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

5 | Continue Funding Municipal Incentive Aid Program

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

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

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

6 | 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. Additional work would need to be provided by the Treasurer's Office. Ultimately, the Commission agreed that further study is necessary to implement this program.

7 | 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 was discussed that critical status be added as an additional event so that there would be two out of six items which might trigger state oversight. This idea, supported by some commission members, is meant as additional criteria for consideration purposes, perhaps preventing some of the dire situations experienced in other communities. It is a means of additional measurement and is not intended to imply that a municipality with a local plan already in critical status would automatically be placed under oversight. The Commission discussed including language that as long as a municipality is "on the pathway" towards an increased funding level and following the funding improvement plan (FIP) this would not be a criteria.   In other words, it remains neutral if a community is following its FIP.

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

8 | Develop a Voluntary MERS Pathway

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

- Consider providing one-time incentives
- Provide specific period to reach benchmark funding requirements
- Allow for re-amortization of recalculated unfunded liability
- Allow members to retain existing service credits
- Provide for state/school aid offset in the event of failure to make required funding payments

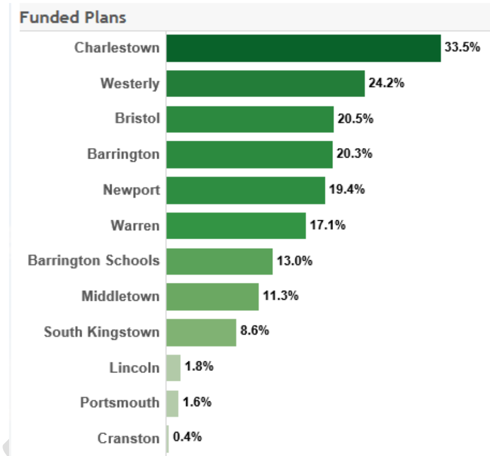
The Commission was not opposed to this recommendation provided that it remains a voluntary and optional pathway.

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.

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

9 | Continue to Monitor OPEB Plans

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



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

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

10 | Consider Funding Improvement Plans for OPEB

The Commission discussed whether to recommend that a funding improvement plan for OPEB, similar to the FIP for pensions, be required. There was no consensus on this although all commission members agreed that this is a substantial liability that will need to be addressed in some way. The Commission recognizes that guidelines would need a different approach due to the magnitude of the issue.

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

Conclusion

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

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

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

Attachment B

[AS OF NOVEMBER 20, 2014]

Recommendations to the Governor and General Assembly

Local Pension & OPEB Study Commission

[Working Document]

[DRAFT]

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Commission Members

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

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

Executive Summary

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

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

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

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

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

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

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

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

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

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

The Crisis

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

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

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

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

Our Challenge

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

> *"The Commission shall review existing legislation and pension plan administrative practices and to make recommendations for the improved security and funding of locally-administered plans and other post-retirement benefit obligations of cities and towns."*
> *(RIGL §45-65)*

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

Guiding Principles

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

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

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

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

Strategies and Accomplishments

Raising awareness and increasing access to information

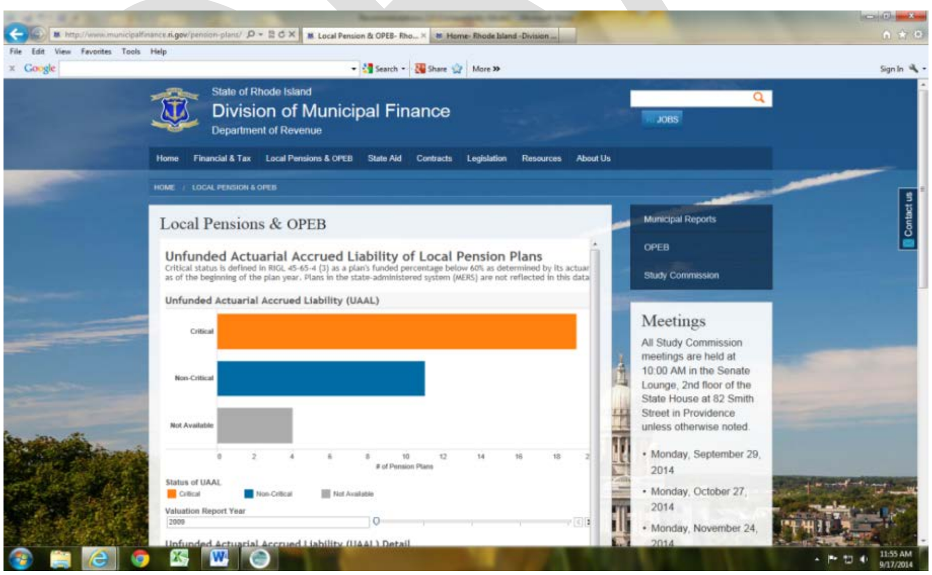
It was important to ensure that stakeholders were aware of the extensive data collected by the Commission and the importance of this information for effective decision-making. This was fundamental to our process. Commission members at one time or another all voiced the sentiment that it is important to have current, relevant data to make informed decisions. The Commission has included an appendix, divided into three parts—part one is supplementary information included specifically for reference to the recommendations; part two includes general pension information such as our recent outreach to all critical status plans highlighting FIP implementation progress and ARC payments planned, paid, and budgeted; part three contains information related to OPEB such as survey results and an important analysis of data based on OPEB valuation reports received through November 2013.

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

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

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

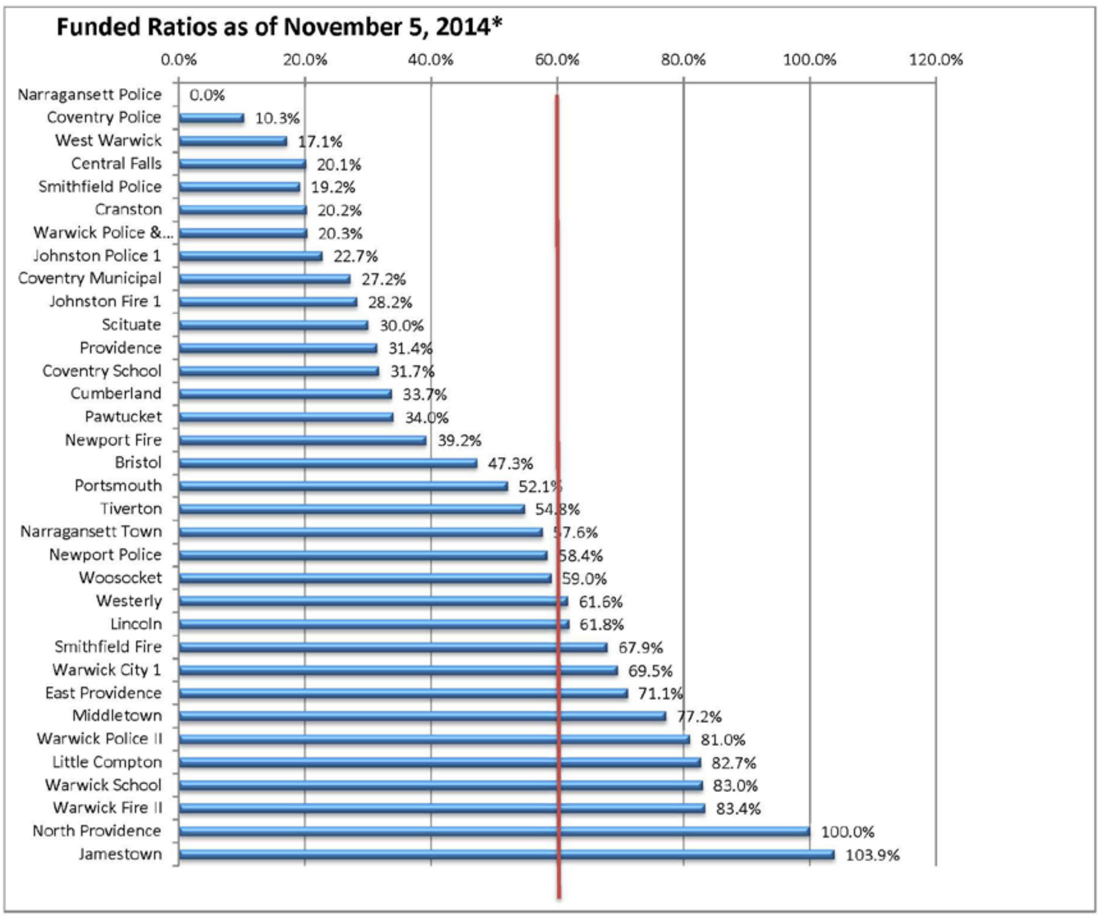
Accurate and detailed minutes of all commission meeting are available on the DMF website. The Division of Municipal Finance has an entire section devoted to pension and OPEB valuations, experience studies and funding improvement plans. DMF assisted the Commission to make it easy for stakeholders—mayors,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



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

Developing shared goals

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



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

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

Delivering training

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

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

Finding

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

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

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

Recommendations Considered

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

1. Establish an oversight board
2. Expand legislation requiring fiscal impact statements
3. Require an annual funding notice
4. Expand proposed budget language in municipal disclosure process
5. Continue funding municipal incentive aid program
6. Administer a voluntary program to invest plan assets
7. Expand criteria for oversight under the fiscal stability act
8. Develop a voluntary MERS pathway
9. Consider funding improvement plans for OPEB
10. Continue to monitor OPEB plans
11. 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 that local plans follow the best practices of actuaries and government financial standards.

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

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

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

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

Commissioners expressed the concern that any proposed board that was not balanced in representation may dictate to the municipalities and/or labor without consideration of the interests of these groups. The commission members were conflicted in determining the composition of a group of impartial oversight board members. Mayors and union representatives had concerns about an oversight body without representation from their groups. Some commission members cited a need for representation of active and retired plan members. Other members expressed the concern that impartiality may be difficult for a sitting mayor/ town manager to take a position contrary to another mayor's/town manager's funding improvement plan.

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

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

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

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

These concepts include:

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

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

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

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

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

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

- Review and accept annual report, prepared by the Division of Municipal Finance, and submit report to the governor and general assembly.

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

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

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

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

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

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

2 | Expand Legislation Requiring Fiscal Impact Statement

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

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

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

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

3 | Require an Annual Funding Notice

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

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

status. Ongoing communication to plan members is important for all local plans, and is a best practice adopted by the private sector.

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

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

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

4 | Expand Proposed Budget Language in Municipal Disclosure Process

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

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

5 | Continue Funding Municipal Incentive Aid Program

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

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

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

6 | 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. Additional work would need to be provided by the Treasurer's Office. Ultimately, the Commission agreed that further study is necessary to implement this program.

7 | 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 was discussed that critical status be added as an additional event so that there would be two out of six items which might trigger state oversight. This idea, supported by some commission members, is meant as additional criteria for consideration purposes, perhaps preventing some of the dire situations experienced in other communities. It is a means of additional measurement and is not intended to imply that a municipality with a local plan already in critical status would automatically be placed under oversight. The Commission discussed including language that as long as a municipality is "on the pathway" towards an increased funding level and following the funding improvement plan (FIP) this would not be a criteria. In other words, it remains neutral if a community is following its FIP.

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

8 | Develop a Voluntary MERS Pathway

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

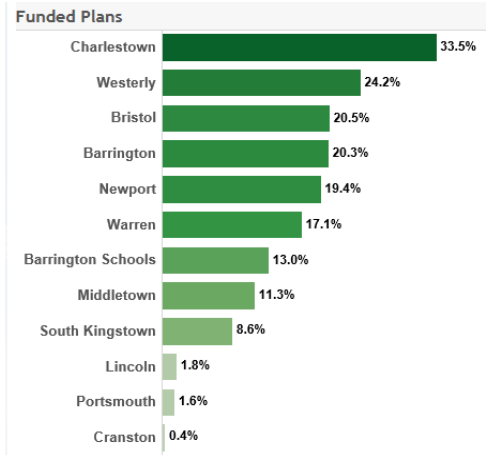
- Consider providing one-time incentives
- Provide specific period to reach benchmark funding requirements
- Allow for re-amortization of recalculated unfunded liability
- Allow members to retain existing service credits
- Provide for state/school aid offset in the event of failure to make required funding 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.

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

9 | Continue to Monitor OPEB Plans



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

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

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

10 | Consider Funding Improvement Plans for OPEB

The Commission discussed whether to recommend that a funding improvement plan for OPEB, similar to the FIP for pensions, be required. There was no consensus on this although all commission members agreed that this is a substantial liability that will need to be addressed in some way. The Commission recognizes that guidelines would need a different approach due to the magnitude of the issue.

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

Conclusion

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

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

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

Sample Funding Policy

Emerald City Pension Plan

The City has adopted a revised funding policy effective (*enter date*) that provides reasonable assurance that the cost of those benefits will be funded in an equitable and sustainable manner. The City, with consultation with its actuary and the most recent Experience Study, shall establish reasonable actuarial assumptions in the determination the liabilities. The essential elements of the Policy are as follows:

Actuarial Cost Method

The costs of the Plan have been determined in accordance with the (*enter method*) actuarial cost method.

Asset Method

Assets held by the fund are valued at market value. The actuarial value of assets is determined using (*enter asset method).*

Amortization Method

Describe how the unfunded accrued liability will be paid. Include the number of years, the rate of increase in payments, if any. Include whether it is a closed or open amortization method. If it is closed, describe how new unfunded liabilities will be amortized when they become known.