

The seal of the Rhode Island League of Cities and Towns is a circular emblem. It features a central map of Rhode Island. Surrounding the map is a ring of small, individual city and town crests. The outer border of the seal contains the text "RHODE ISLAND LEAGUE" at the top and "OF CITIES AND TOWNS" at the bottom, separated by a rope-like border.

# Potential Implications of Modifying the RI Retirement Security Act of 2011

**Rhode Island League of Cities and Towns**

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# Background

In November of 2011, the General Assembly enacted the Rhode Island Retirement Security Act of 2011 (Act). Shortly thereafter, all retirees and active employees impacted by the Act initiated litigation contesting the Constitutionality of the reform measure. In December of 2012, a State Superior Court Judge assigned to the case ordered the parties into mediation supervised by the Federal Mediation and Conciliation Service (FMCS). Various attorneys represent the Governor (including Claire Richards, Chief Legal Counsel and Richard Licht, Director of Administration), the General Treasurer (including Mark Dingley, Chief Counsel/Deputy Treasurer, John Tarantino, Esq and David Boies, Esq.) and the Employees Retirement System of RI. Various and numerous labor unions represent the plaintiffs. On January 14, 2013 a court imposed gag order was decreed on all communication on the progress of the mediation. Both the President and Executive Director of the RI League of Cities and Towns have expressed concern that the cities and towns have no direct

representation at the table, notwithstanding the fact that every one of Rhode Island’s thirty-nine cities and towns will be impacted by either a mediated settlement or litigated court decision.

The impetus for reform resulted from the actuarial valuation reports (**AVR**) for state employees, school teachers and all municipal employees enrolled in the Municipal Employees Retirement System (MERS) for June 30, 2010 issued by Gabriel, Roeder, Smith & Company (GRS) in May of 2011. These two reports changed the investment return assumptions from 8.25% to 7.5%. The report also modified payroll growth, mortality, and disability assumptions. These assumption changes along with the phasing in of the additional investment losses resulted in very significant employer contribution requirements. Table 1 compares aggregate employer contribution estimates in FY 2012 based upon the June 30, 2009 **AVR** with the contributions required by the June 30, 2010 **AVR**.

Table 1

Reduced pension fund investment returns and other actuarial assumption changes increased projected city and town pension costs from \$175 million in Fiscal Year 2012 to \$287 million in Fiscal Year 2013, a <b>64% increase.</b>	Employer Contributions	6/30/2009 AVR <sup>(1)</sup> FY 2012 Cost \$ Existing	6/30/2010 AVR <sup>(2)</sup> FY 2013 Cost \$ Existing
		<b>TEACHERS</b>	
	State Share	\$95.8	\$151.0
	<b>Local Share</b>	<b>\$143.7</b>	<b>\$221.0</b>
	Total Teachers	\$239.5	\$372.0
	<b>MUNICIPAL EMPLOYEES</b>		
	Regular Municipal	\$19.8	\$41.0
	Municipal Police & Fire	\$11.5	\$25.0
	<b>All Local</b>	<b>\$175.0</b>	<b>\$287.0</b>

# Background *continued...*

Absent any change in benefits, local employer contributions for the local share of teachers pensions and for participants in the MERS were projected to increase from \$175 million in FY 2012 to \$287 million in FY 2013. This was an increase of \$112 million dollars or 64%. A similar magnitude of increase was projected for state employees and the state's share of teachers' retirement cost. Thus began the pension reform initiative which focused on suspending COLAs, reducing pension accruals, changing retirement age and the years of service necessary to qualify for a pension. Simultaneously, it was proposed to replace a portion of the defined benefit plan with a defined contribution plan going forward.

Prior to passage of the final act, the state's actuary (GRS) provided an analysis of the Act to the House and Senate Finance Committees. That communication projected employer funding contribution requirements going forward. All cities and towns were impacted by changes to the teachers' retirement system because all teachers in the state participate in this system and school districts pay

60% of the employer contribution. Many city and towns were also impacted by changes to the MERS because their municipal employees and public safety employees were enrolled in these plans.

The GRS communication dated November 14, 2011 indicated that annual municipal employer contributions for teachers and municipal employees would be \$287 million in FY 2013 without reform. The cost with reform would be \$154.9 million. The following March in their June 30, 2011 actuarial report GRS restated municipal cost at \$159.9 in FY 2013. The principle differences were in the payroll base. Additionally, the November GRS summary did not include MERS employees who were not employed directly by a city or town. The most significant examples would be housing authorities and fire districts. In December, GRS distributed its actuarial valuation as of June 20, 2013 which would be used for determining employer contributions in FY 2016. Table 2 summarizes projected city and town employer contributions from the 2010 and 2013 Annual Valuation Reports (AVR).

Table 2

Employer Contributions	6/30/2010 AVR <sup>(2)</sup> FY 2013 Cost \$ Existing	6/30/2010AVR <sup>(2)</sup> FY 2013 Cost \$ Reform	6/30/2010AVR <sup>(3)</sup> FY 2013 Cost \$ Reform	6/30/2013AVR <sup>(4)</sup> FY 2016 Cost \$ Reform
<b>TEACHERS</b>				
State @ 40%	\$151.0	\$83.1	\$83.9	\$98.3
<b>Local @ 60%</b>	<b>\$221.0</b>	<b>\$120.4</b>	<b>\$121.5</b>	<b>\$143.4</b>
Total Teachers	\$372.0	\$203.5	\$205.4	\$241.7
<b>MUNICIPAL EMPLOYEES</b>				
Regular Municipal	\$41.0	\$24.6	\$27.6	\$31.8
Municipal Police & Fire	\$25.0	\$9.9	\$10.8	\$16.5
<b>All Local Contributions</b>	<b>\$287.0</b>	<b>\$154.9</b>	<b>\$159.9</b>	<b>\$191.7</b>

# Summary

In summary, the pension reform act was initially projected to result in a reduction of municipal employer cost from \$287 million to \$155 million or \$132 million less. Remember that the \$287 million in non reform contributions was driven principally by a change in investment return assumptions (from 8.25% down to 7.5%) as well as other assumption changes and recognized investment losses. Municipal contributions in FY 2012 were \$175 million of which \$143.7 million was the local share of teacher contributions. Thus, pension reform resulted in moderately reduced municipal employer contributions in FY 2013 compared to FY 2012 rather than an extraordinary increase. Table 2 only reflects the cost of the defined benefit program. A new additional cost of pension reform for state and municipal employees was a new defined contribution plan as incorporated in Table 3.

Including the defined contribution commitment, costs to cities and towns were approximately the same as they incurred in FY 2012. Three years later, they will have increased over \$30 million. It should be noted that the defined contribution estimate for FY 2016 is unverified. It assumes no growth from the estimate provided in November of 2011 by the actuary.

The GRS report of November 2011 did forecast employer contributions for state employees and teachers over a 30 year period. It made no such forecast for municipal employees or public safety employees. The growth in contributions for teachers has been reasonably consistent with what was forecast 3 years ago. The annual increase in the aggregate for municipal employees has been just under 5%. The annual average increase for public safety employees has been over 17%. It has not been possible to clearly determine the relative drivers in public safety defined benefit cost increases.

Table 3

<b>Local Employer Contributions</b>	<b>FY '12 History</b>	<b>FY '13 No Reform</b>	<b>FY '13 Reform Est.</b>	<b>FY '13 Reform Rev.</b>	<b>FY '16 Projected</b>
<b>DEFINED BENEFIT</b>					
Local – Teachers	\$143.7	\$221.0	\$120.4	\$121.5	\$143.4
Regular Municipal	\$19.8	\$41.0	\$24.6	\$27.6	\$31.8
Municipal Police & Fire	\$11.5	\$25.0	\$9.9	\$10.8	\$16.5
<b>DEFINED CONTRIBUTION</b>					
Local – Teachers			\$16.0	\$16.0	\$16.0
Regular Municipal			\$2.0	\$2.0	\$2.0
Municipal Police & Fire			\$1.0	\$1.0	\$1.0
<b>Total Local</b>	<b>\$175.0</b>	<b>\$287.0</b>	<b>\$173.9</b>	<b>\$178.9</b>	<b>\$210.7</b>

# Mediation

**B**ecause of the gag order, nothing is officially known. What is known is that approximately two thirds of the unfunded liability savings and consequent employer contribution modifications resulted from the virtual suspension of COLAs. Other significant contributors were changes in future accruals and retirement age requirements.

There were special factors applicable to municipal employees and public safety employees. For regular municipal employees, employee contributions had been greater for those groups who chose to receive a COLA (virtually all large groups). These members and retirees have strenuously argued that since they had a slightly higher retirement contribution to receive a COLA, they should receive the full COLA they paid for.

The public safety lobby has also made a vigorous argument that the retirement age (55 and 25 years of service) was too high for employees performing these kinds of services. They also argue that many of their local collective bargaining agreements referenced years of service and/or retirement age. They argue that these local contractual commitments cannot be reversed unilaterally. From a management perspective, the reform act as heard before committee included a provision which would have modified municipal accidental disability pensions (unless totally disabled) to 50% of compensation (instead of 66 2/3 %). Unfortunately, this provision was removed by an amendment during the final vote on the act for reasons that up until this day have never been explained to any municipal employer in the state!

When cities and towns argue that they should have a seat at the table, they argue from a position that they have a special expertise on the issues facing municipal employers that neither the Governor nor General Treasurer possess. This is especially true in the public safety area where costs have already increased dramatically over the three year period since passage of the reform act. City and town officials universally believe that a seat at the table is warranted to protect their collective interests.



**Cities and towns do not have direct representation at the table in the mediation talks.**

Lastly, it is both interesting and important to note that municipal officials are not alone in voicing their concern and frustration about what may be taking place behind closed doors at FMCS. Early in this new year, House Speaker Fox expressed his concern and Senate President Paiva Weed expressed her frustration that a proposed settlement may emerge from the court ordered talks that would force the General Assembly to wrestle again with public employee pensions.

# Implications of a Potential Mediated Agreement

**1.) Reamortized settlement:** One likely scenario is that mediation will result in some benefit improvements for some or all of the litigants, the cost of which will be reamortized over a 30 year period (instead of the existing 25 year schedule) such that annual employer costs will remain essentially the same. Obviously, the overall cost will be much greater, but it will be more difficult for municipal officials to argue that the settlement is a budget buster. It is important to note the conundrum local officials will face if a reamortized settlement is to be considered by the General Assembly. Should they support a settlement that has no immediate and costly fiscal implications on their budgets, or should they oppose reamortizing the long term, onerous fiscal liabilities created by the benefit structure as they did back in 2011?

**2.) Adverse municipal mediated agreement:** It has been the concern of local officials since the mediated negotiations began that the attorneys representing the state will primarily focus on a state employee, state retiree, school teacher and teacher retiree settlement. Municipal employees and retirees may very well have already become a secondary concern in this ongoing secret process. If this scenario takes place, the parties to the agreement might be able to applaud themselves on an agreement which has no adverse budgetary cost to the state, but the same applause may not be applicable to municipalities. This could be due to the fact that the statutory provisions of the MERS benefit structure have been codified over the years in many municipal labor agreements, particularly those for police officers and firefighters. As noted before, local officials are especially concerned that the public safety lobby will achieve concessions

relating to retirement age and years of service that are budget busters for many cities and towns, particularly those already deemed to be distressed.

**3.) Indirect Impact on Locally Administered Pension Plans:** As stated earlier in this report, many cities and towns were directly impacted by the passage of the Act and they will also be directly impacted by a potential mediated agreement because their municipal employees and public safety employees are enrolled in MERS. However, it is also important to note that even those municipalities whose employees were not enrolled in MERS would be indirectly affected by a mediated settlement because the reforms in state pension law have become the benchmark for reforming the locally administered plans, especially as it relates to investment return, COLA's and retirement age.

## Implications of No Mediated Agreement

Litigation will continue and there will be no adverse impact for several years; however, the long term risks are significant. The plaintiff's arguments will be as follows:

- 1.) Pension benefits are contractual in nature.
- 2.) If the court affirms that they are contractual in nature then the court must also determine that there has been substantial impairment.
- 3.) If it is affirmed that there was substantial impairment then the court must determine whether this impairment served a greater governmental purpose. Labor, active employees and retirees will argue that there were other reasonable solutions.

# Conclusion

The major positive of a mediated settlement would be removal of uncertainty going forward. While it is unlikely that a settlement will require significant increased annual contributions for state employees or teachers, there is risk that there will be significant increased cost requirements for municipal employees, particularly for their active and retired public safety employees.

While failure to achieve a settlement will limit any

immediate adverse cost impact, there is real risk that a final litigated result will be extremely costly to cities and towns. This result may not be known for several years and it is likely that an adverse decision by the Superior Court will be appealed to the Supreme Court, thus protracting even further a final resolution of the legality and fiscal consequences of the Rhode Island Retirement Security Act of 2011 on the state and its political subdivisions.

## FOOTNOTES:

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<sup>(1)</sup> *Actuarial Valuation Report (AVR)* issued May 4, 2011 by Gabriel Roeder Smith & Company.

<sup>(2)</sup> *Communication to House and Senate Finance Committee Chairs* by Gabriel Roeder Smith & Company dated November 14, 2011.

<sup>(3)</sup> *Actuarial Valuation Report (AVR)* issued March 23, 2012 by Gabriel Roeder Smith & Company.

<sup>(4)</sup> *Actuarial Valuation Report (AVR)* issued December 12, 2013 by Gabriel Roeder Smith & Company.