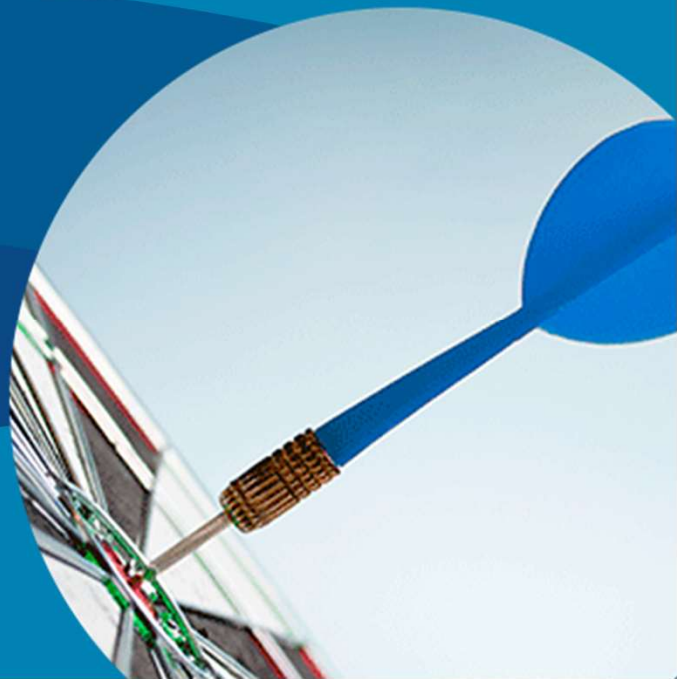
# A lookback at the Rhode Island Retirement Security Act of 2011

S1111A and H6319A

Joe Newton

November 2, 2023



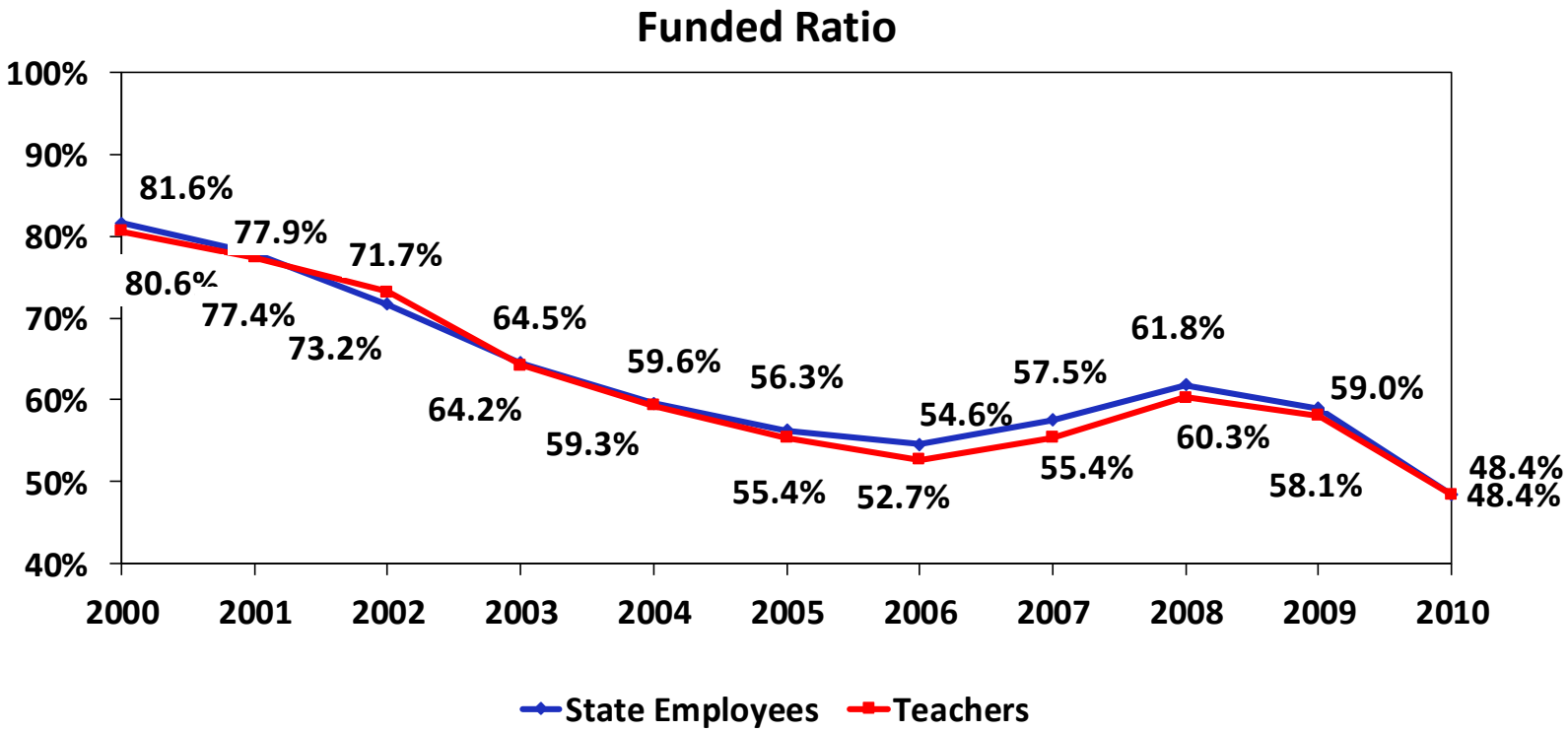
# Agenda

- What prompted the 2011 reforms?
- Explain the nature and intent of the 2011 reforms
- Provide an overview of where the system is today
- Assess where the system (and stakeholders) might be but-for reform

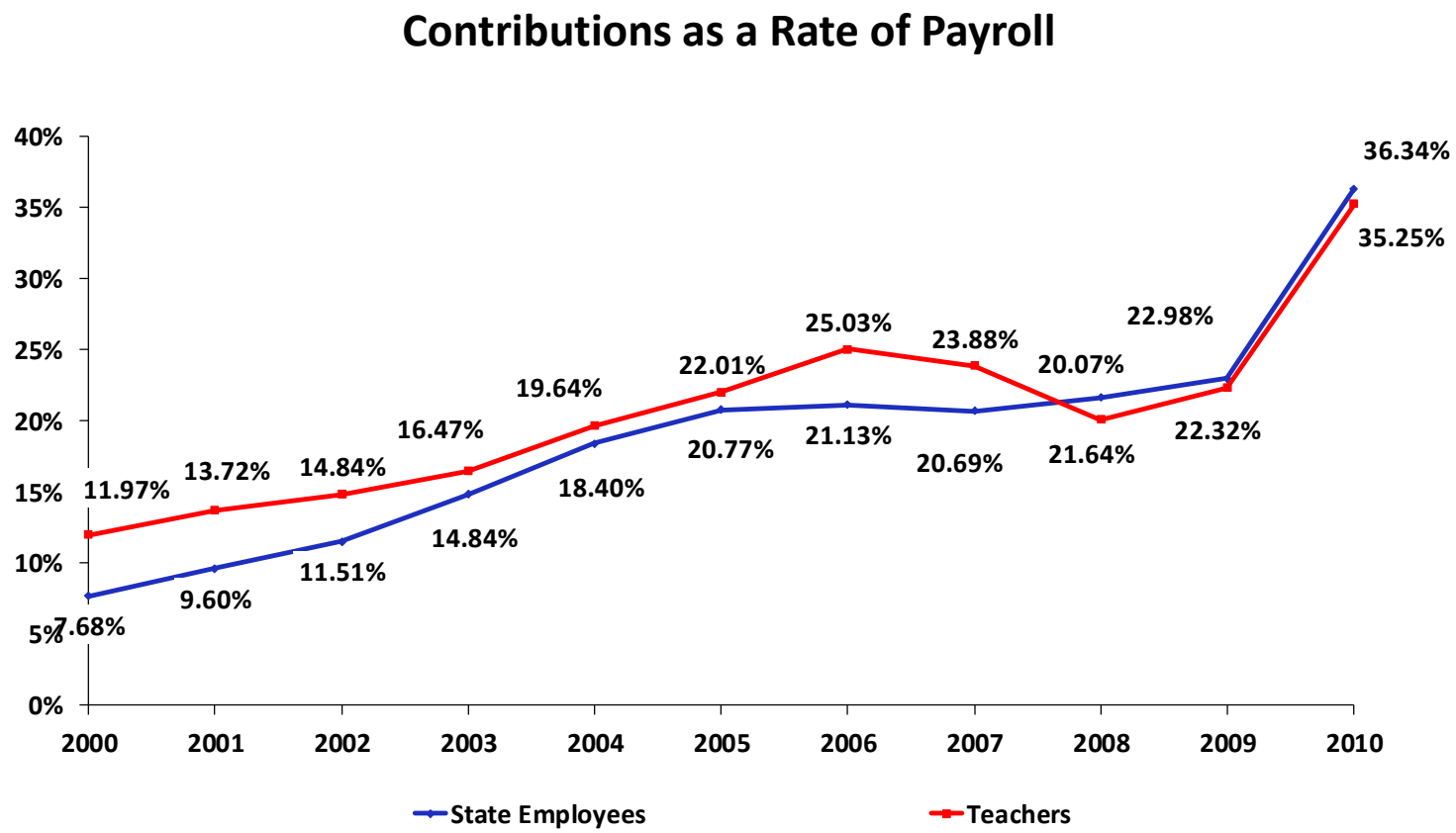
# Economic Realities of the 2000's

- The previous benefit design was very back-loaded, which lead to a high ratio of liability to payroll (or employer budget) as the plan matured
- Active headcount had contracted heavily, at least partially due to the previous pension and healthcare reforms, which exacerbated the issue
- Thus, when the dot.com bubble was followed by the Great Recession, the funding levels of the pension trusts deteriorated to dangerously low levels
- 78% of the liability was in the retirees and actives already eligible to retire, meaning most of the benefit payouts were going to happen over the next 10-15 years and was putting strain on the cash flow
  - This limited the ability to use re-amortization alone

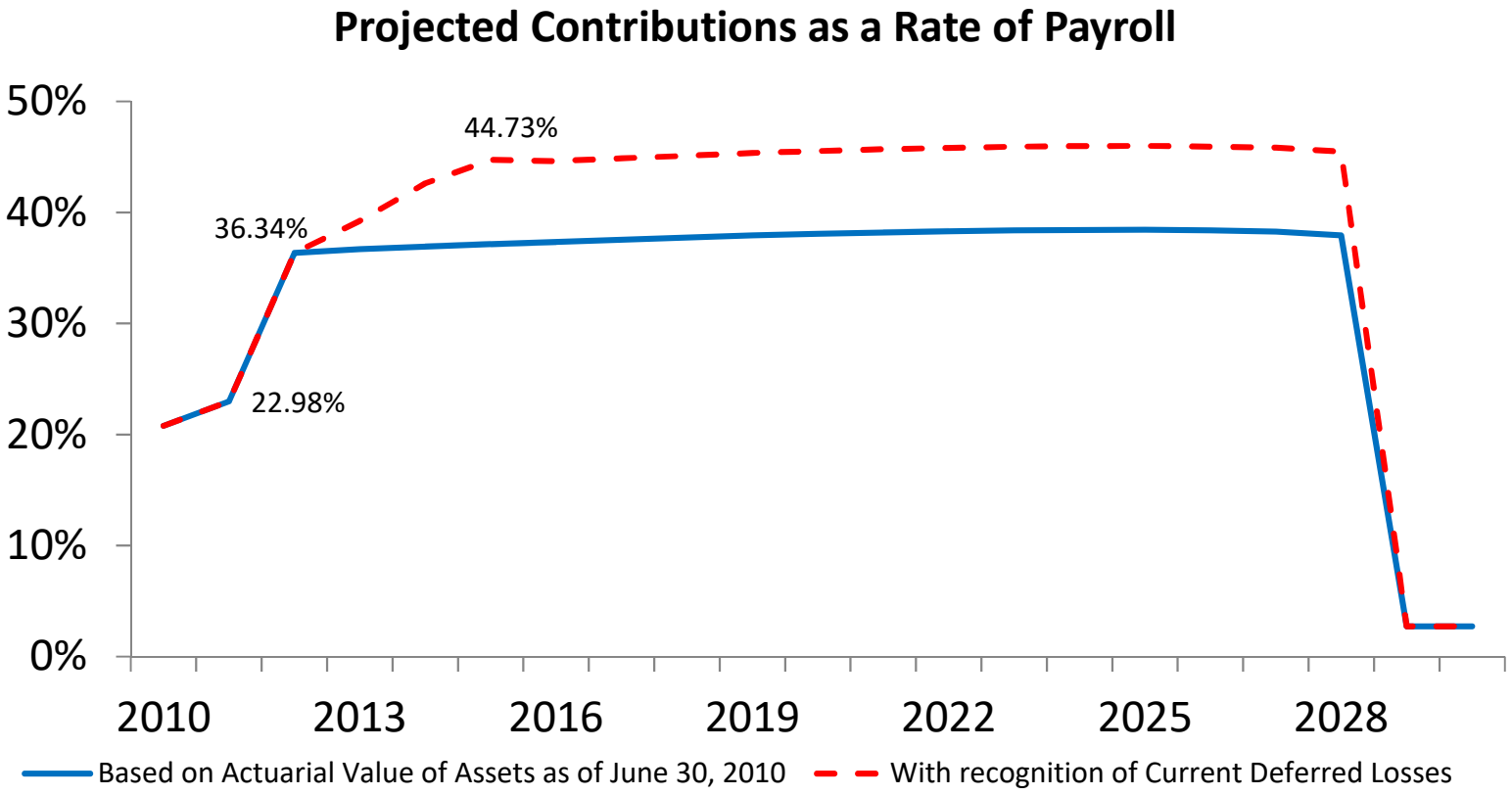
# The Funded Ratios had dropped below 50%



# Employer Contribution Rates had already been increasing, and then finally spiked based on the 2010 valuation

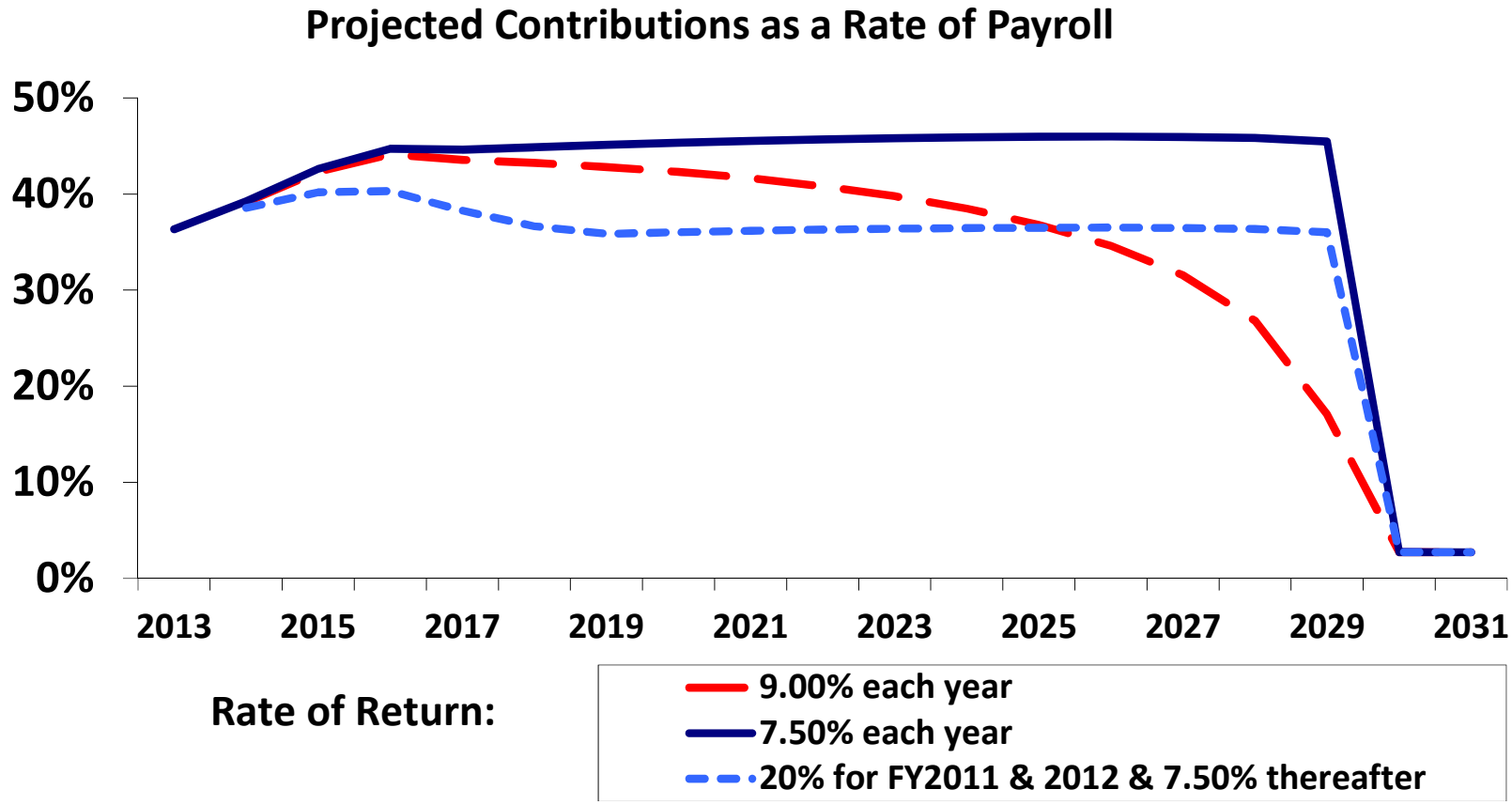


# Contributions were projected to go higher: State Employees



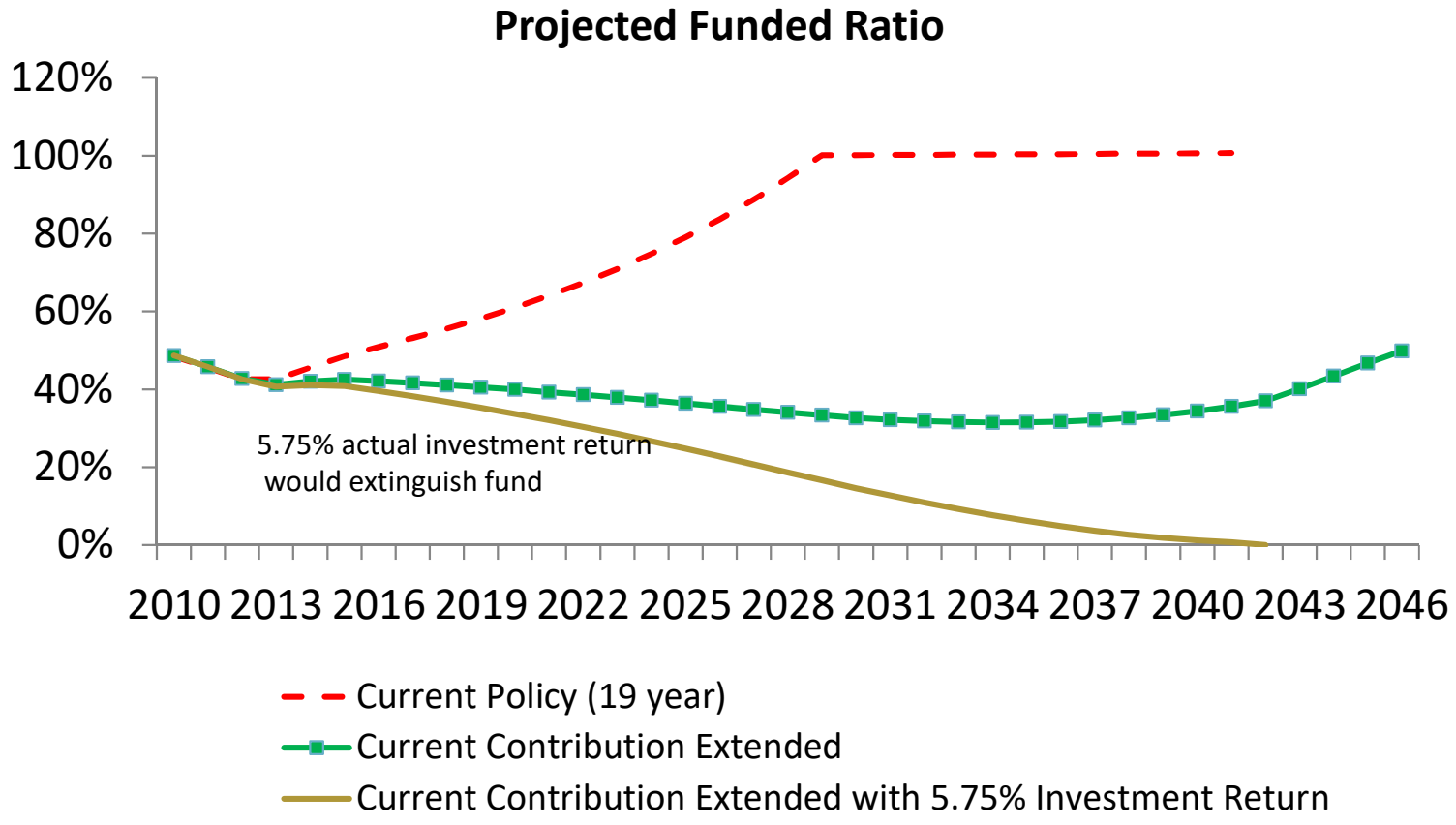

- **Assumes ARC met each year and actual investment return of 7.50% during each year**
- **Assumes continuation of current amortization policy and current member rate**
- **Payroll grows at assumed 3.75% per year**

# Neither a back-to-back 20% return, or a sustained 9% per year return would return contributions to previous levels




- Expected ARC at each valuation date based on stated return during each year
- Assumes continuation of current amortization policy and current member rate
- Payroll grows at assumed 3.75% per year

# If the contributions were not significantly increased, the funded status would continue to deteriorate



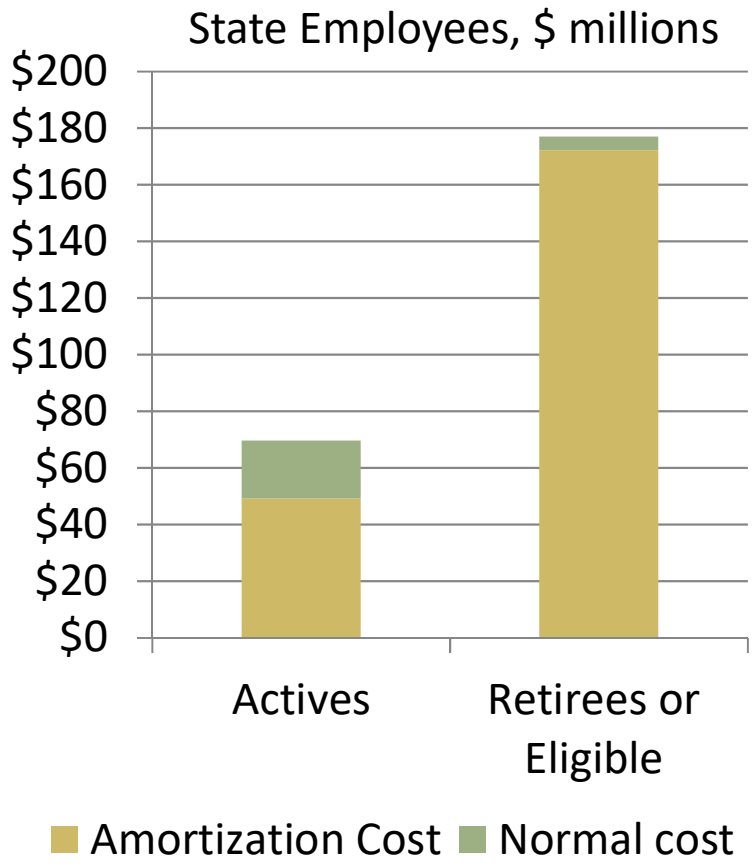

- **Assumes 22.98% employer contribution each year and actual investment return of 7.50% during each year after 2011**
- **Payroll grows at assumed 3.75% per year**

# There had already been several rounds of reform prior to 2011

- Effective 2005: Introduction of Schedule B for **Non-Vested**
- Effective 2008: Extension of Retirement Ages, Schedule B COLA for All members **Not Eligible to Retire**
- Effective 2009: Reduction of COLA to first $35,000 for members **Not Eligible to Retire**
- Effective 2009: Significant change to post retirement healthcare benefits
- Total estimated reduction in value as of June 30, 2010: $500 M (State Employees Only, pension only)

# Sources of Cost

- Nearly 90% of employer cost was attributable to amortization costs
- 78% of the amortized costs are associated with current retirees and those eligible to retire



# Even if current actives were just refunded their contributions, still needed a significant increase in contributions

| | Valuation Results ($ in millions) | Total | Current Retirees and Eligible to Retire | Current Actives |
|---|---|---|---|---|
| 1. | Accrued Liabillity | $5,204 | $4,284 | $920 |
| 2. | Assets | 2,532 | 2,206 | 326 |
| 3. | Unfunded actuarial accrued liability | $2,672.0 | $2,078.3 | $593.7 |
| 4. | Funded ratio | 48.66% | 51.49% | 35.45% |
| 5. | FY 2012 Projected Contributions | | | |
| | Employer Normal Costs | 25.3 | 4.9 | 20.4 |
| | Amortization Payments | 221.2 | 172.1 | 49.2 |
| | Total Employer Contributions | $246.5 | $176.9 | $69.5 |
| | As a percentage of Payroll | 36.85% | 26.45% | 10.40% |
| | Employee Contributions | 55.1 | 8.9 | 46.3 |
| | Total | $301.6 | $185.8 | $115.8 |

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

# What are the next steps?

- Sustainability can only be improved from three areas based on the actuarial funding equation:

$$C + I = B$$

  - Where:
    - C = Contributions
    - I = Investment Earnings
    - B = Benefits



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# Questions to answer

- How do we deal with the current situation?
  - Affordability, sustainability
- What is equitable amongst generations of stakeholders?
- What should the prospective plan look like?
  - Target replacement income
- How can we ensure we are not back here again?
  - Appropriate risk sharing

# The Details of RIRSA: State and Teachers

| Provision | Current Plan | New Plan |
|---|---|---|
| **Member Contribution Rate** | 8.75/9.50% (State/Teachers) | 3.75% (State & Teachers) |
| **DC Member Contributions** | | 5.00% + 1.00% ER Match |
| **Unreduced Retirement Eligibility** | 65/10, 62/29 | SS NRA; Transition rules: 1) eligibles remain eligible; 2) those age 52+ and vested with retirement age <62 can retire at 62; 3) members with 10+ years of service may retire at current retirement as of 6/30/12 with benefit at distribution date calculated using accrued benefit as of 6/30/12 |
| **Reduced Retirement Eligibility** | 62/20, reduced from 65 | 5 Years from NRA, reduced |
| **COLA (All members, including current retirees)** | CPI capped at 3%, on first $35,000 | Investment related (2% target at 7.5% investment returns on first $25K)<br>For all others, COLA suspended until 80% funding reached<br>A COLA will occur every 5th year during the suspension<br>When COLA returns, delayed until later of SS NRA or 3 yrs after retirement |
| **Average Salary Period** | 5 Years | 5 Years |
| **Vesting** | 10 Years | 5 Years for DB<br>3 Years for DC |
| **Amortization Schedule** | 19 Years | 25 Years |

# Distribution of changes across generations

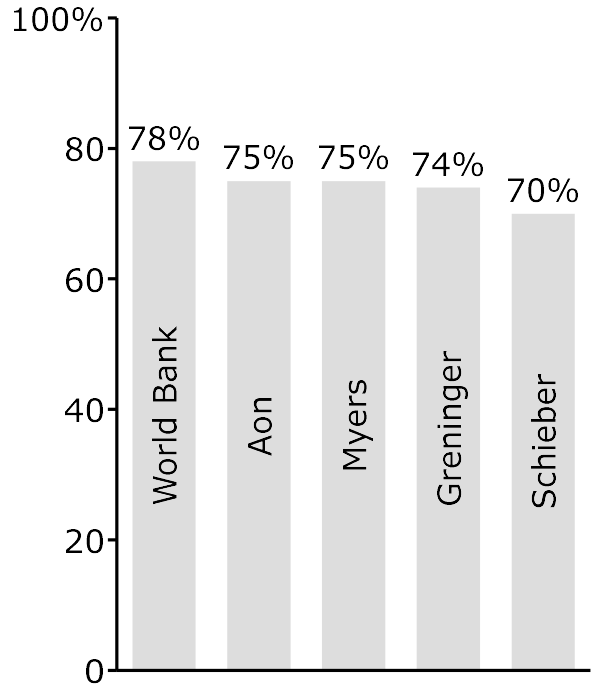
| | Current Retirees and Members Eligible to Retire | Current Vested | Non-Vested and New Hires |
|---|---|---|---|
| Relative Value of Current Benefits from DB Plan | 100 | 81 | 76 |
| | | | |
| Illustrated changes to the current DB Plan | -19% | -24% | -50% |
| Relative Value of Illustrated DB Plan | 81 | 61 | 38 |
| | | | |
| Value replaced by Illustrated DC Plan | N/A | 17 | 38 |
| Approximate Relative Value of Combined Illustrated Plan | 81<br>75 State Risk/6 Self Risk * | 78<br>55 State Risk/23 Self Risk | 76<br>38 State Risk/38 Self Risk |

Relative Value above is a measurement tool to compare the benefit packages to one another.
The Schedule A Plan received a score of 100, with all other scores distributed accordingly

* Future COLAs will be tied to the funding level and investment performance of the Fund

# What should the benefit levels be from a pension program: Experts recommend 65-80% replacement income in retirement from all sources

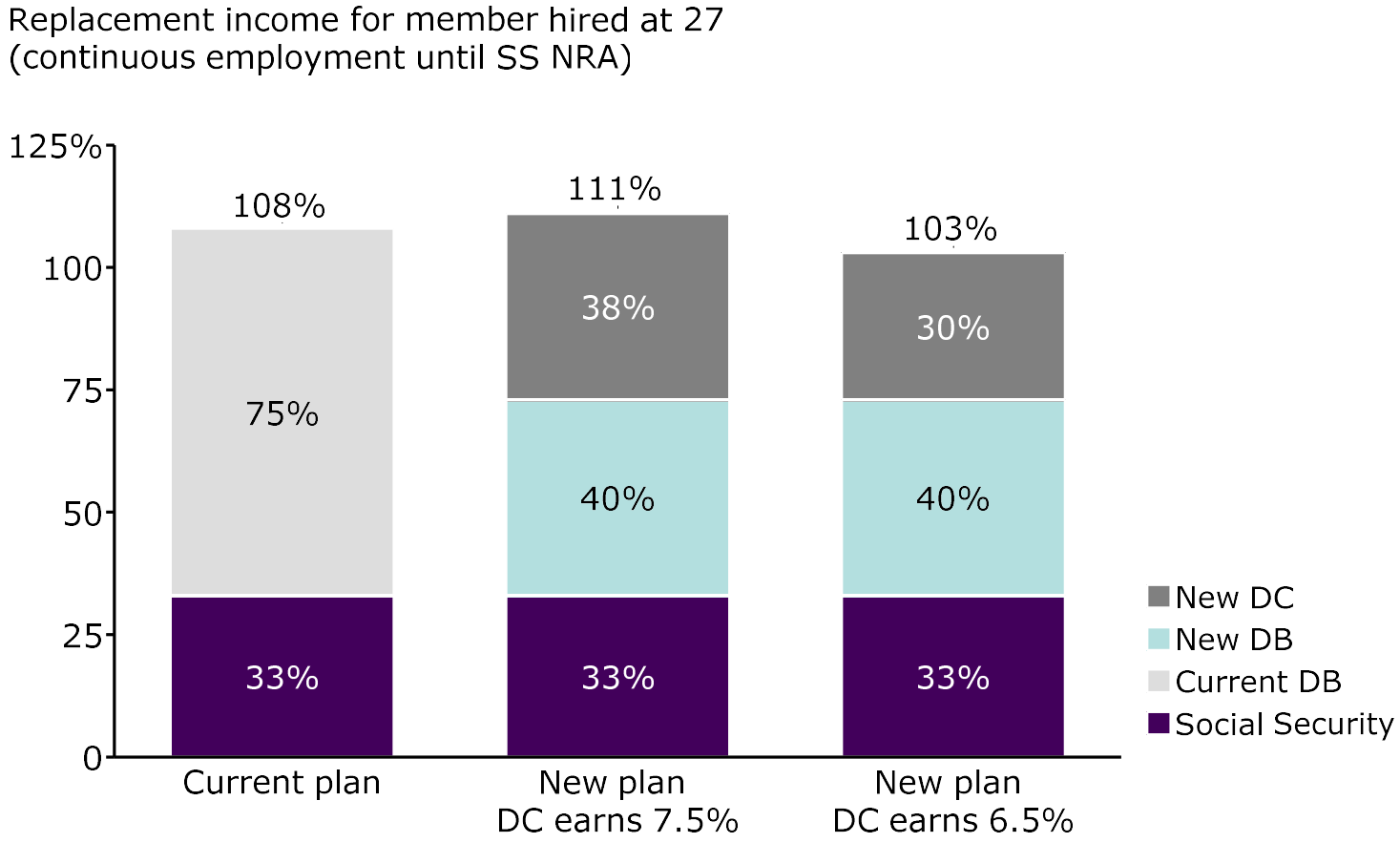
Average recommended replacement rates (studies may point to varying rates based on income)




| | Replacement rate from RI pension alone | |
|---|---|---|
| **Years of service** | **Schedule A** | **Schedule B** |
| **10** | 17% | 16% |
| **20** | 36% | 34% |
| **25** | 51% | 44% |
| **30** | 66% | 55% |
| **35** | 80% | 68% |

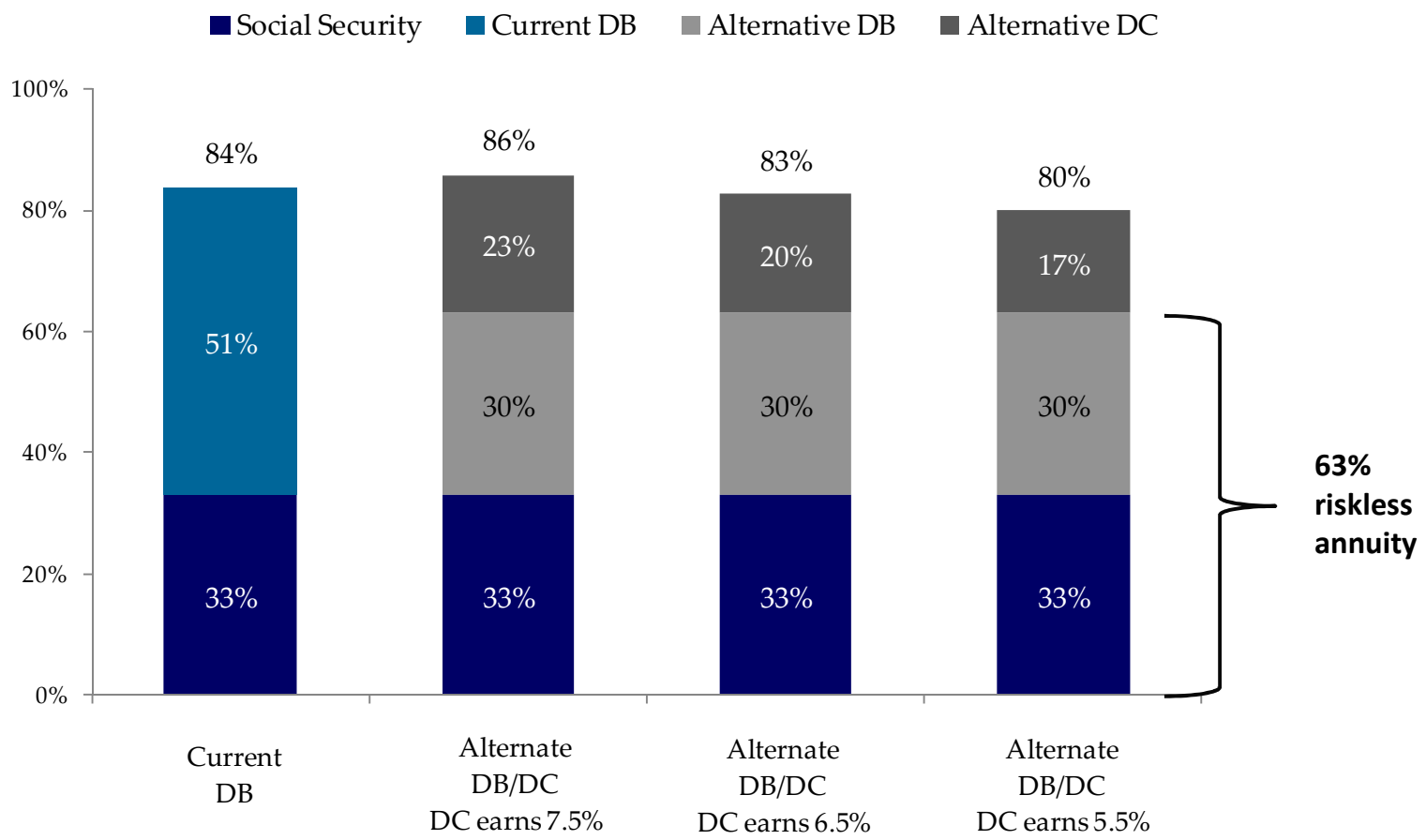
Source: Retirement at Risk: A New National Risk Index," "Alternate Measures of Replacement Rates for Social Security Benefits and Retirement Income" – Social Security Administration; ERSRI

# Considering social security, a member working a full career can get full salary replacement, even in the new plan




*Assumes DC plan can earn stated return during active employment and annuitize the balance at 5.00% actuarial equivalence at retirement

# Even with 30-year career, employee has 63% riskless annuity and the new structure is expected to provide retirement income in line with or above expert recommendations




*Assumes DC plan can earn stated return during active employment and annuitize the balance at 5.00% actuarial equivalence at retirement



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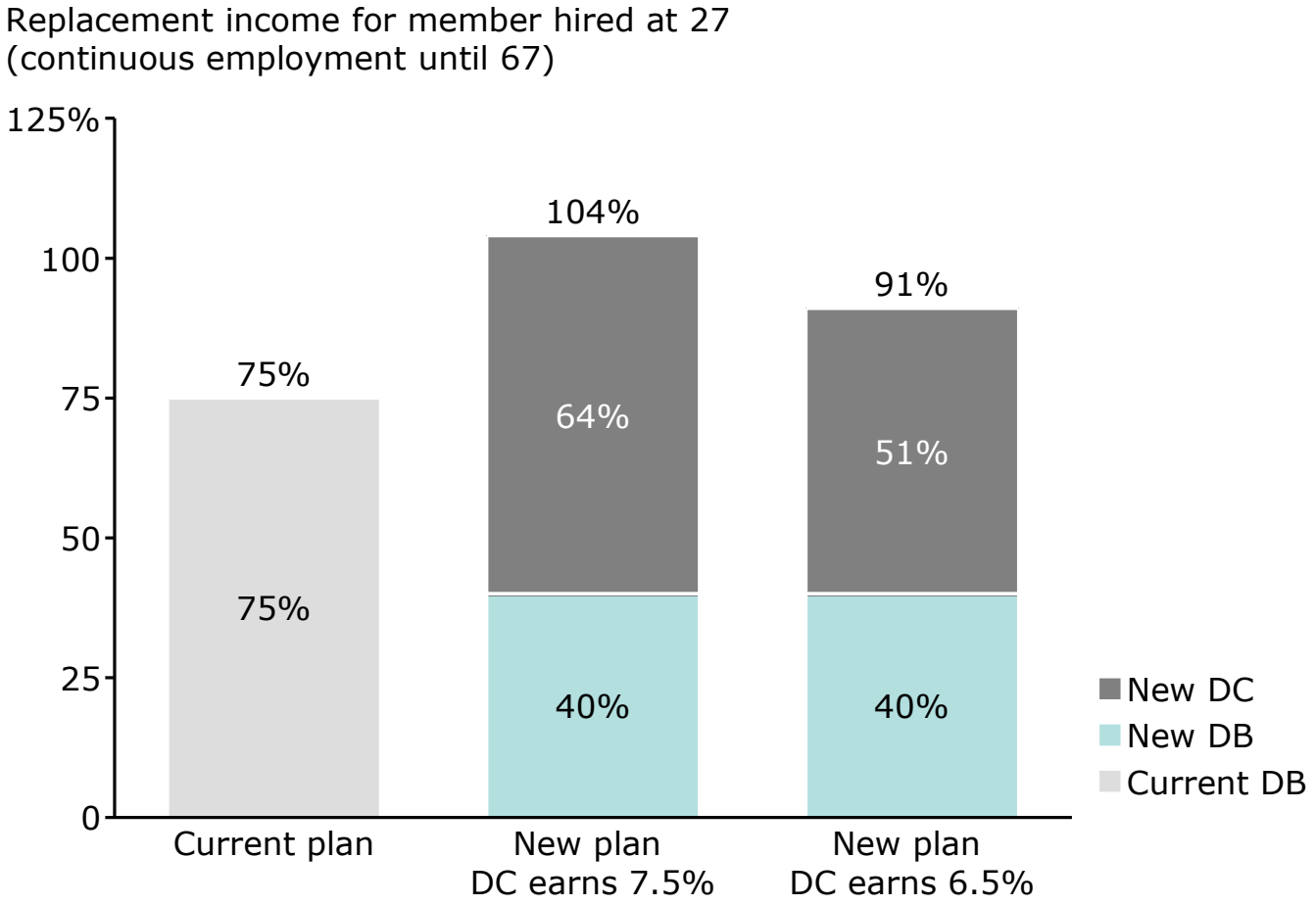
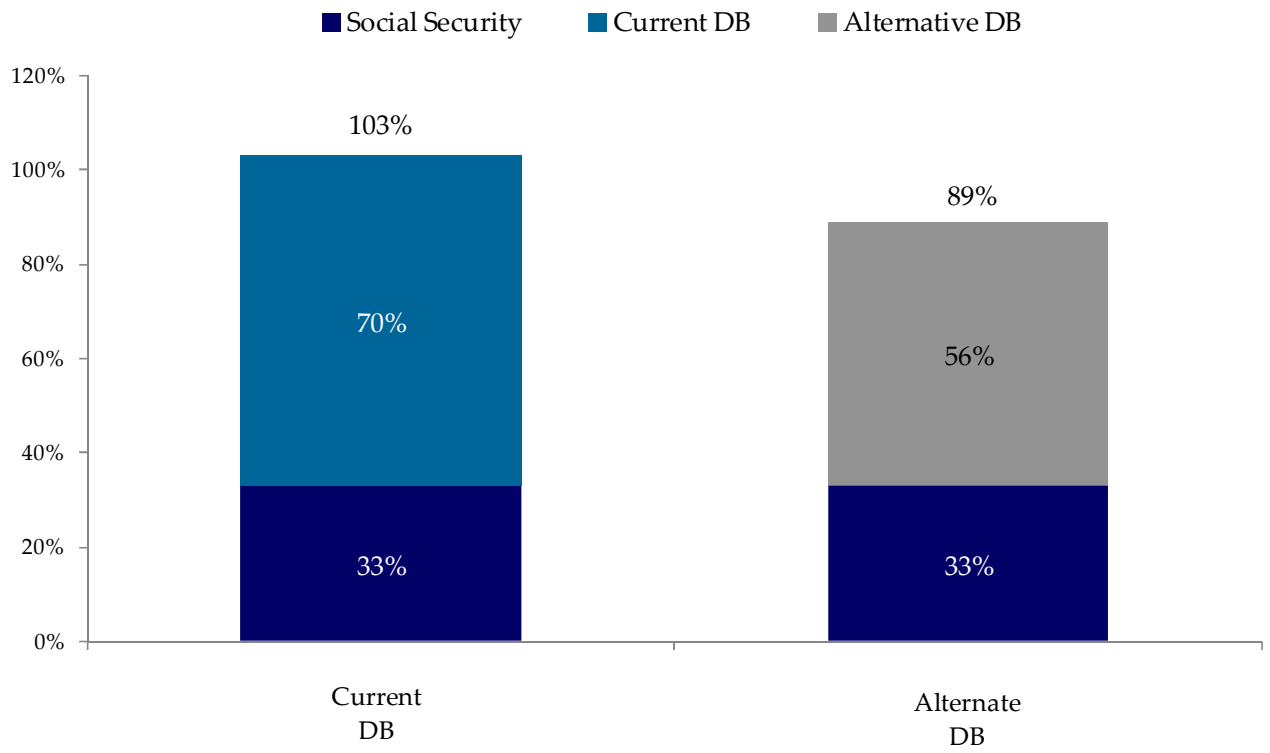
# Those without Social Security had an increase in benefits and also earn within the expert recommended levels




A DC supplement is needed to meet the replacement income goals

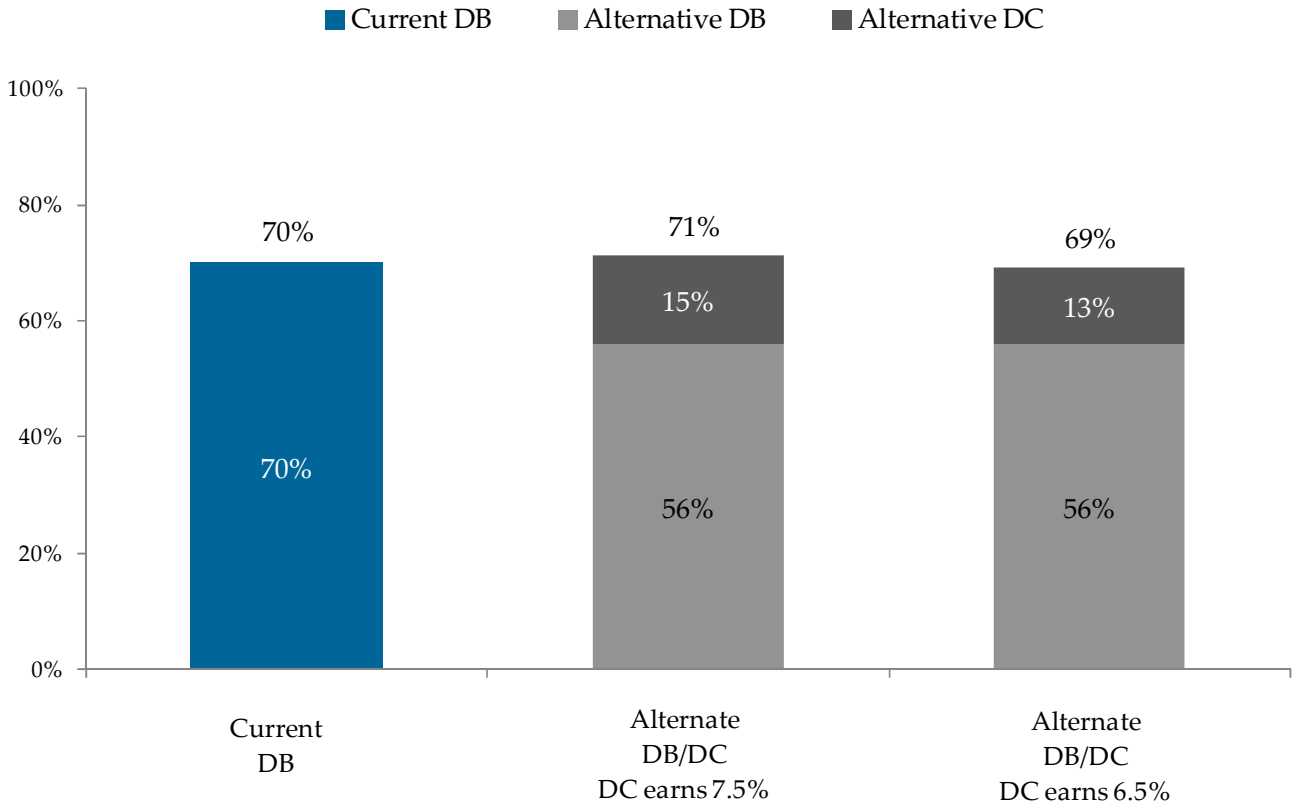
# Proposed Plan: MERS P&F Example Changes in Replacement Value

New Hire at age 27, Continuous Employment until Age 55
(28 Year career)



# Proposed Plan: MERS P&F
# Without Social Security: 3%/3% DC contribution

New Hire at age 27, Continuous Employment until Age 55
(28 Year career)





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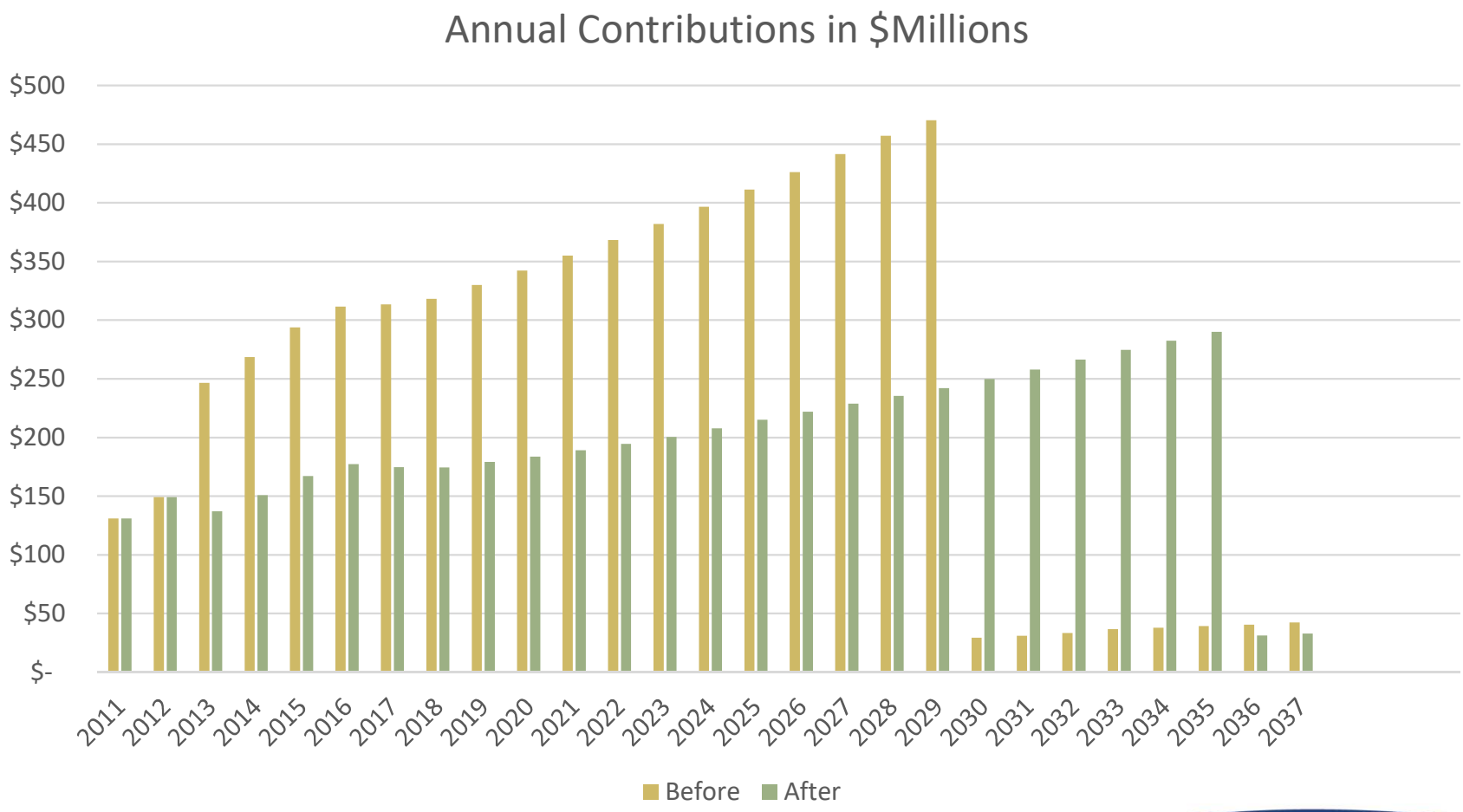
# Fiscal Impact: State Employees

| Valuation Results *(in millions) | Baseline (Current) | Proposed (incl. 1% DC) | Change |
|---|---|---|---|
| FY 2013 Contribution Rate | 36.34% | 21.35% | -14.99% |
| Normal Cost Percentage | 11.39% | 9.19% | -2.20% |
| Unfunded Liability* | $2,700.4 | $1,644.5 | ($1,055.9) |
| Funded Ratio | 48.4% | 60.6% | 12.20% |
| Long Term Normal Cost | 11.39% | 6.24% | -5.15% |
| FY 2013 Contribution* | $243.0 | $169.7 | ($73.30) |
| ***Out-years*** | | | |
| *FY 2014 Contribution Rate* | *38.92%* | *22.69%* | *-16.23%* |
| *FY 2015 Contribution Rate* | *41.23%* | *24.25%* | *-16.98%* |
| *FY 2016 Contribution Rate* | *42.35%* | *24.85%* | *-17.50%* |

# Fiscal Impact: On Municipalities
# $ in millions

| | | | Proposed Contributions | | |
|---|---|---|---|---|---|
| | FY 2012 Contribution | FY 2013 Baseline | Defined Benefit | Defined Contribution | Total |
| MERS Municipal | $20.37 | $40.93 | $24.59 | $2.18 | $26.77 |
| MERS Police and Fire | $12.77 | $24.81 | $10.68 | $0.99 | $11.67 |
| **MERS Subtotal** | **$33.14** | **$65.74** | **$35.27** | **$3.17** | **$38.44** |
| Teachers Retirement | $142.82 | $220.95 | $112.49 | $16.17 | $128.66 |
| **Total MERS/Teachers** | **$175.95** | **$286.69** | **$147.76** | **$19.34** | **$167.10** |

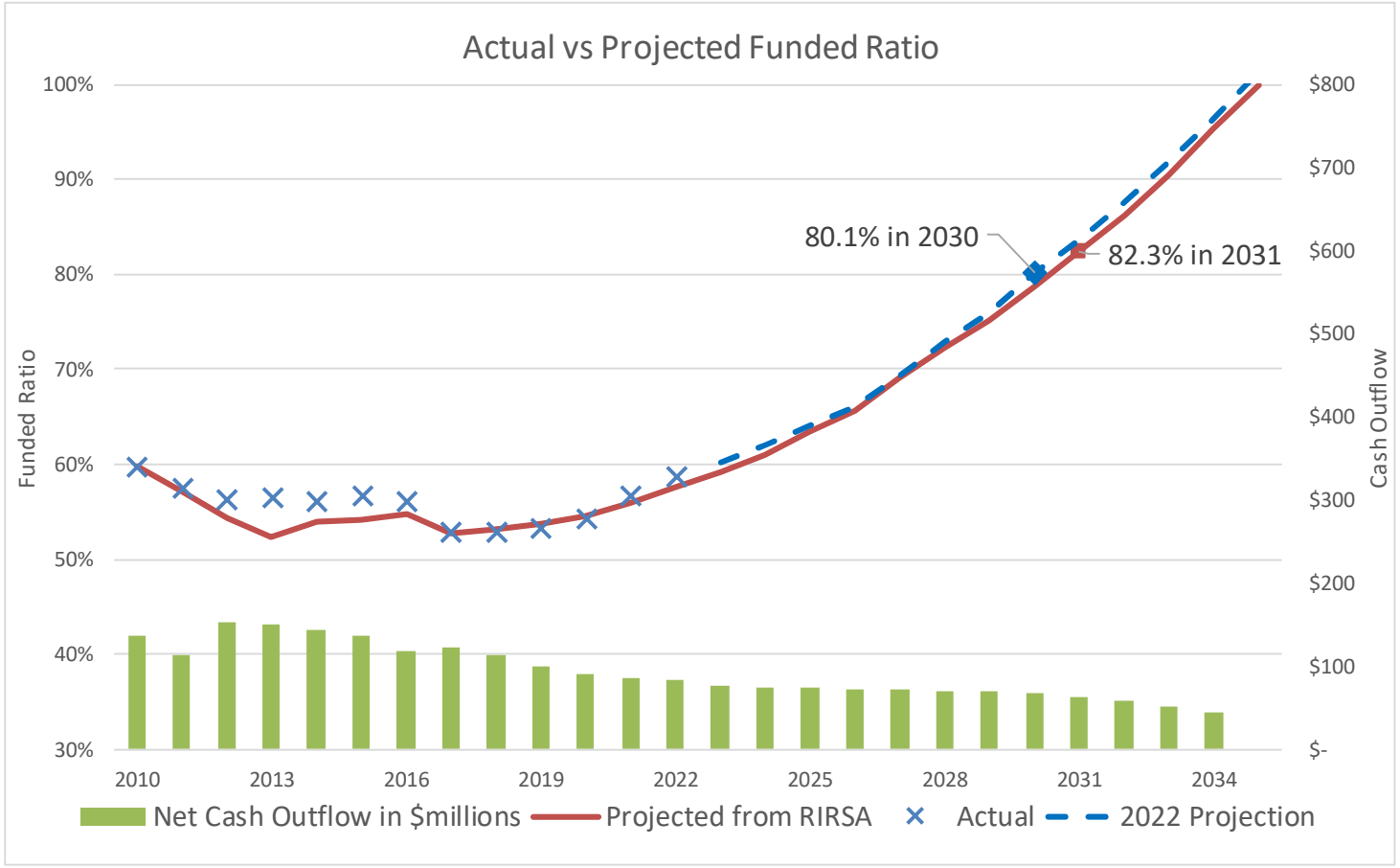
# Projections from 2011: State Employees



# WHAT HAS HAPPENED SINCE THE 2011 LEGISLATION AND WHAT IS THE CURRENT STATUS OF THE PENSION PLANS?

# Funded Ratio History

*Compared to Original RIRSA Projections – State Employees*

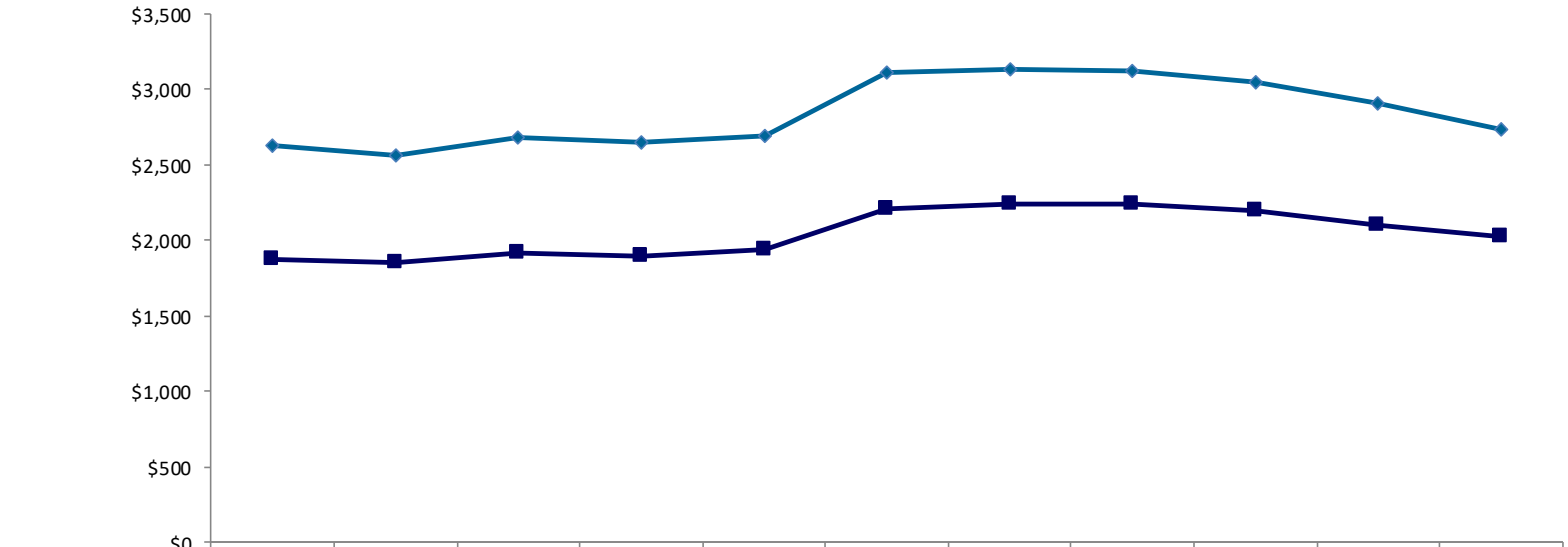



Original Projections from the RIRSA Impact Statement, adjusted for Mediation changes in 2016 (-1.4%) and change to investment return assumption in 2017 (-2.7%)

# Actuarial Valuations as of June 30, 2022

*Historical Unfunded Actuarial Accrued Liability (UAAL)*

$ in millions



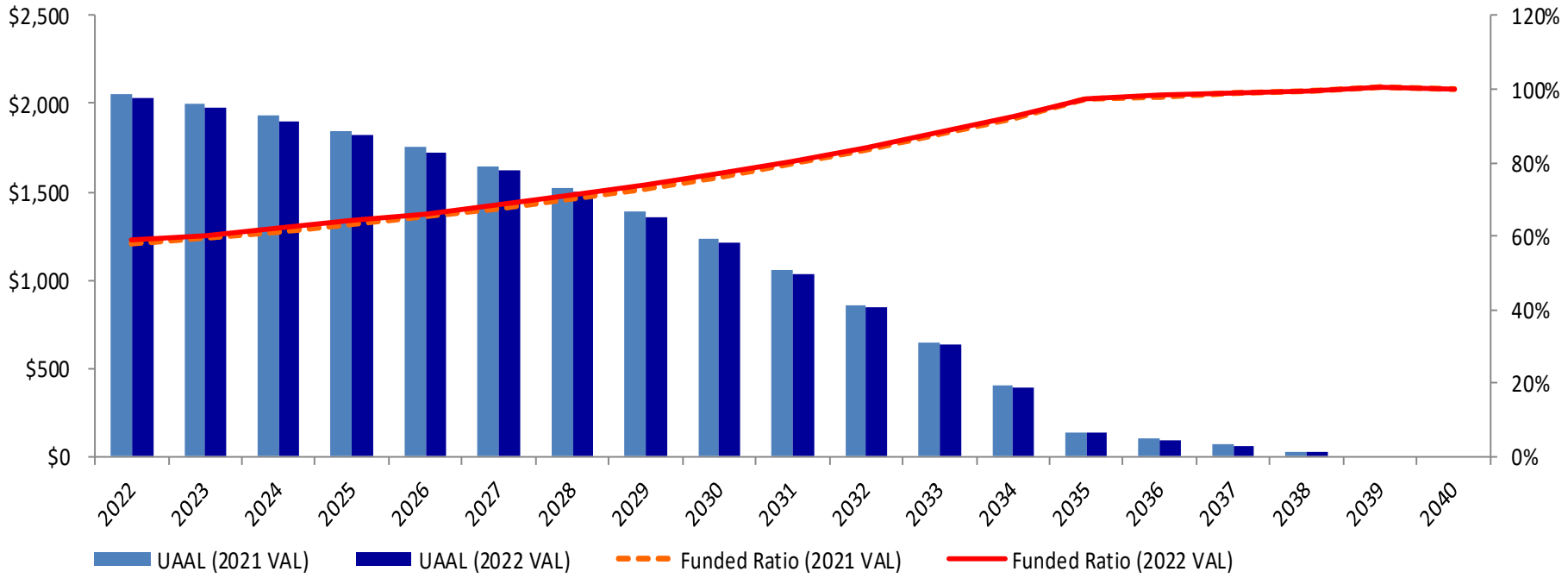

| | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| State Employees | $1,876 | $1,855 | $1,920 | $1,895 | $1,936 | $2,213 | $2,239 | $2,244 | $2,196 | $2,100 | $2,032 |
| Teachers | $2,627 | $2,568 | $2,682 | $2,655 | $2,694 | $3,116 | $3,136 | $3,128 | $3,046 | $2,909 | $2,735 |

Investment Return Assumption lowered from 7.5% to 7.0% in 2017

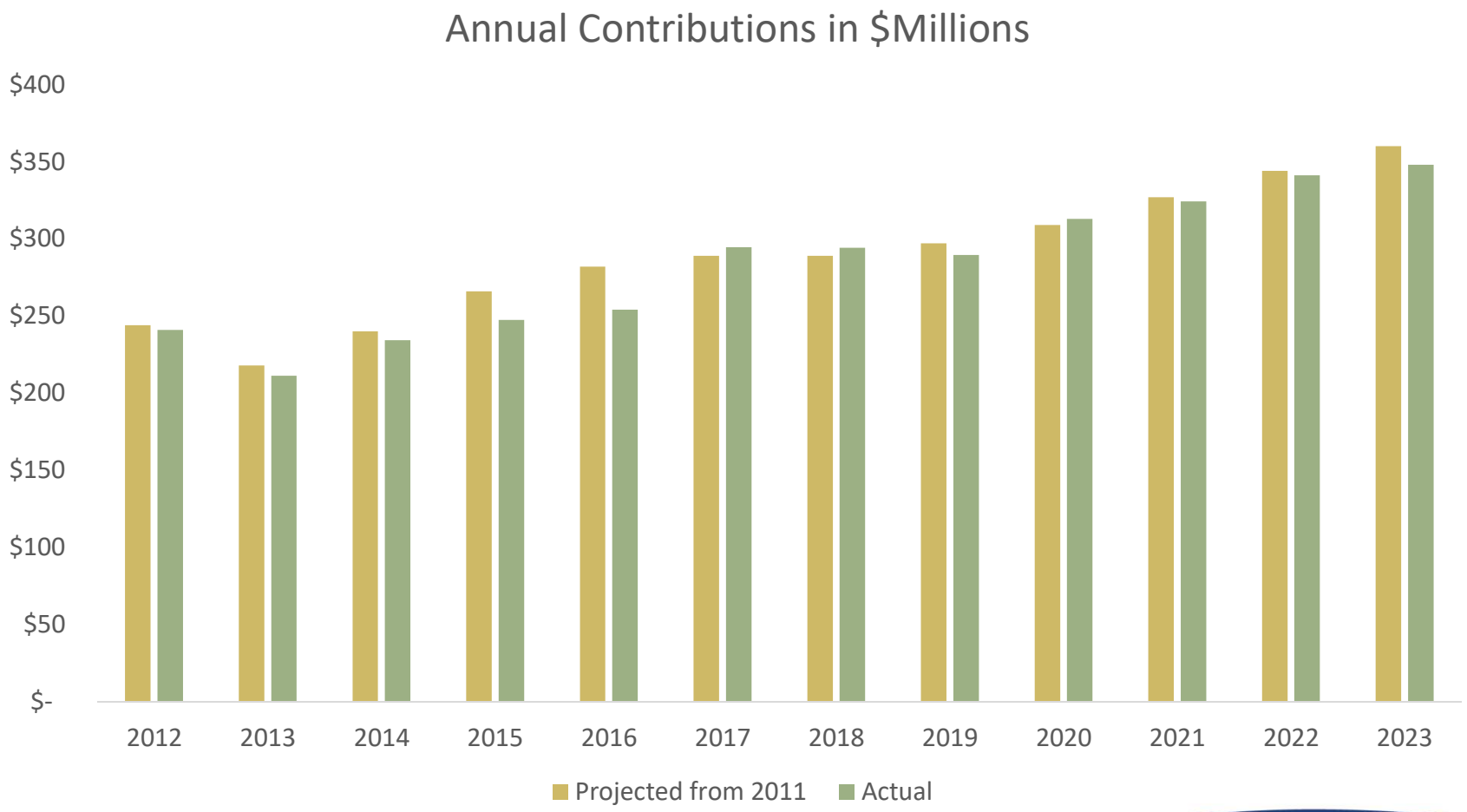
# Projected Unfunded Liability

*State Employees*

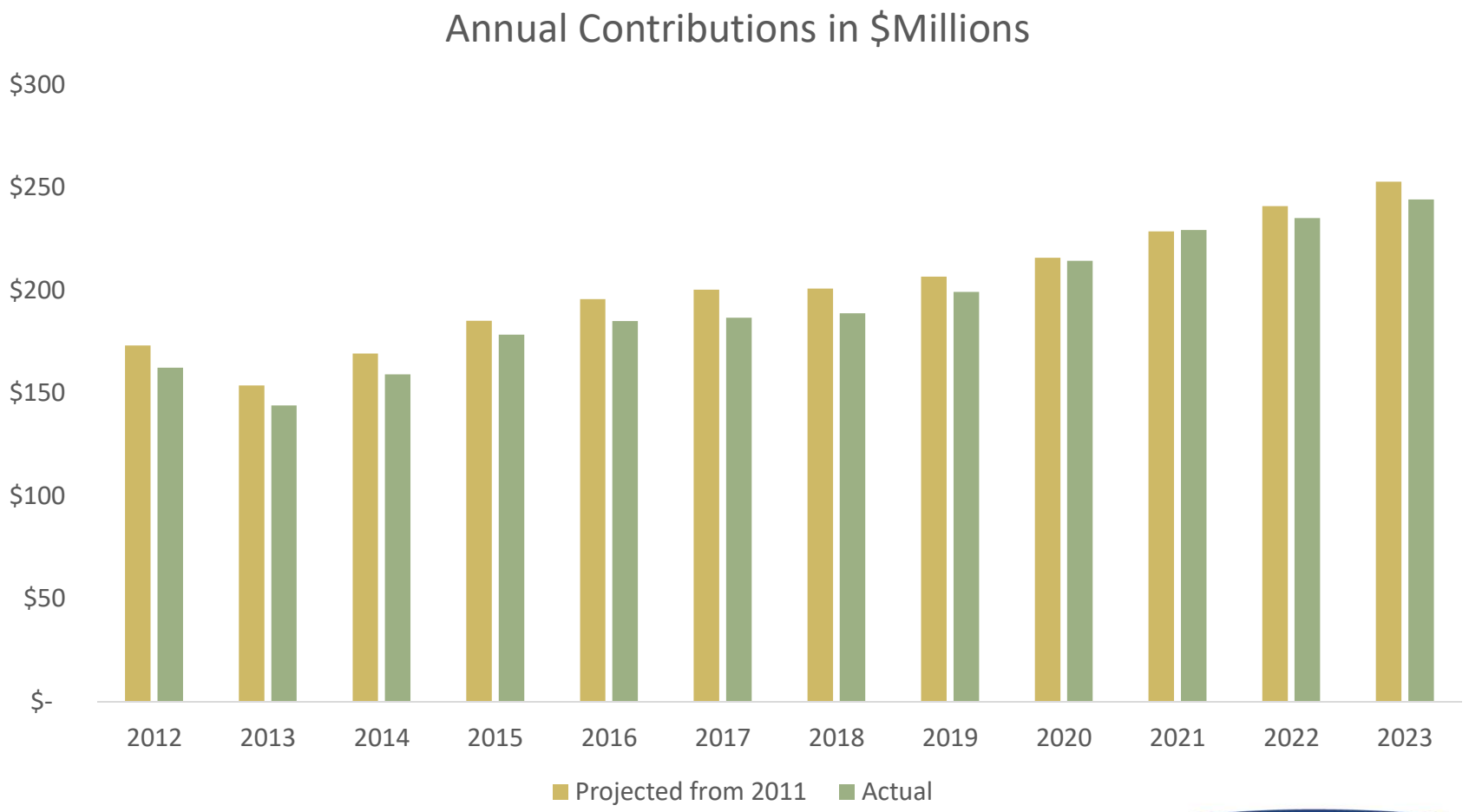
**$ in Millions**



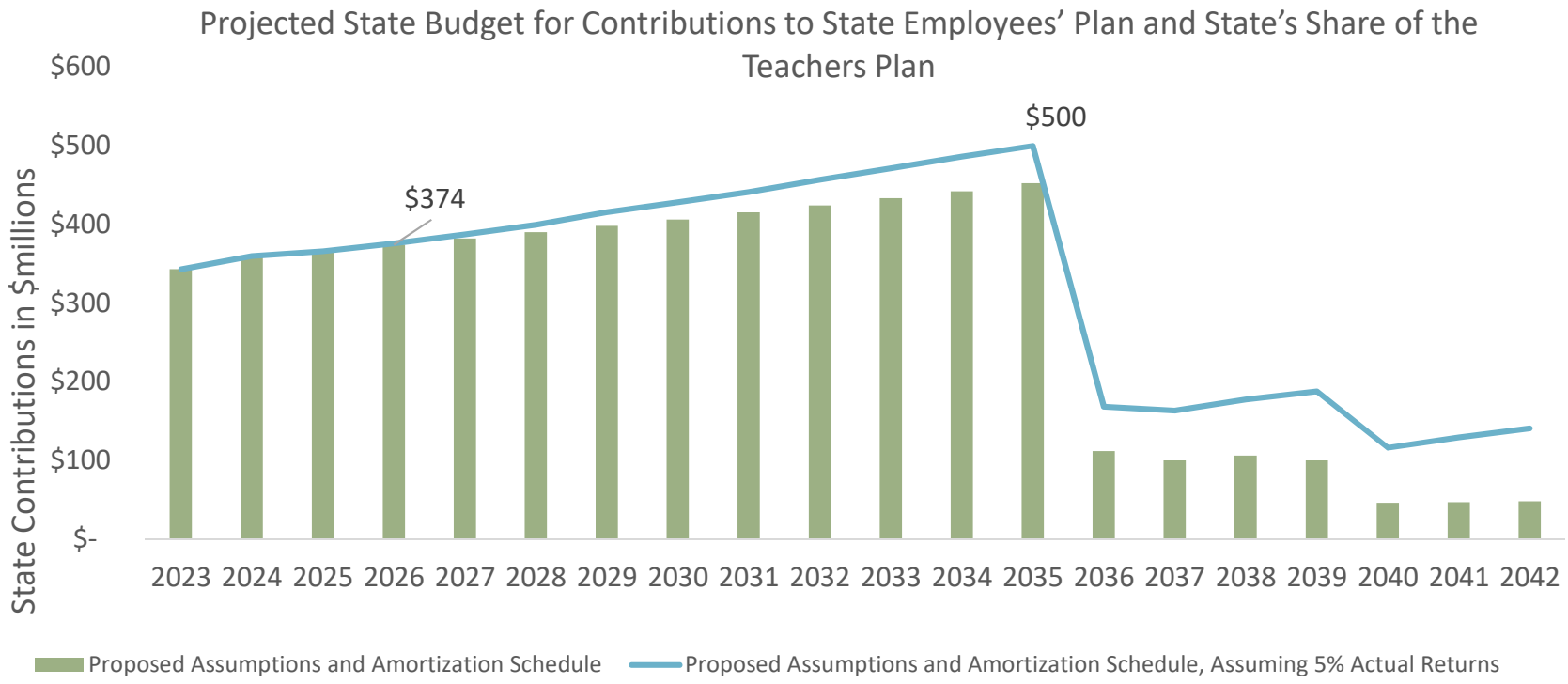
# Actual Compared to Projections: ERS State Share, State Police, Judges



# Actual Compared to Projections: ERS Local Share, MERS



# Projected State Budget

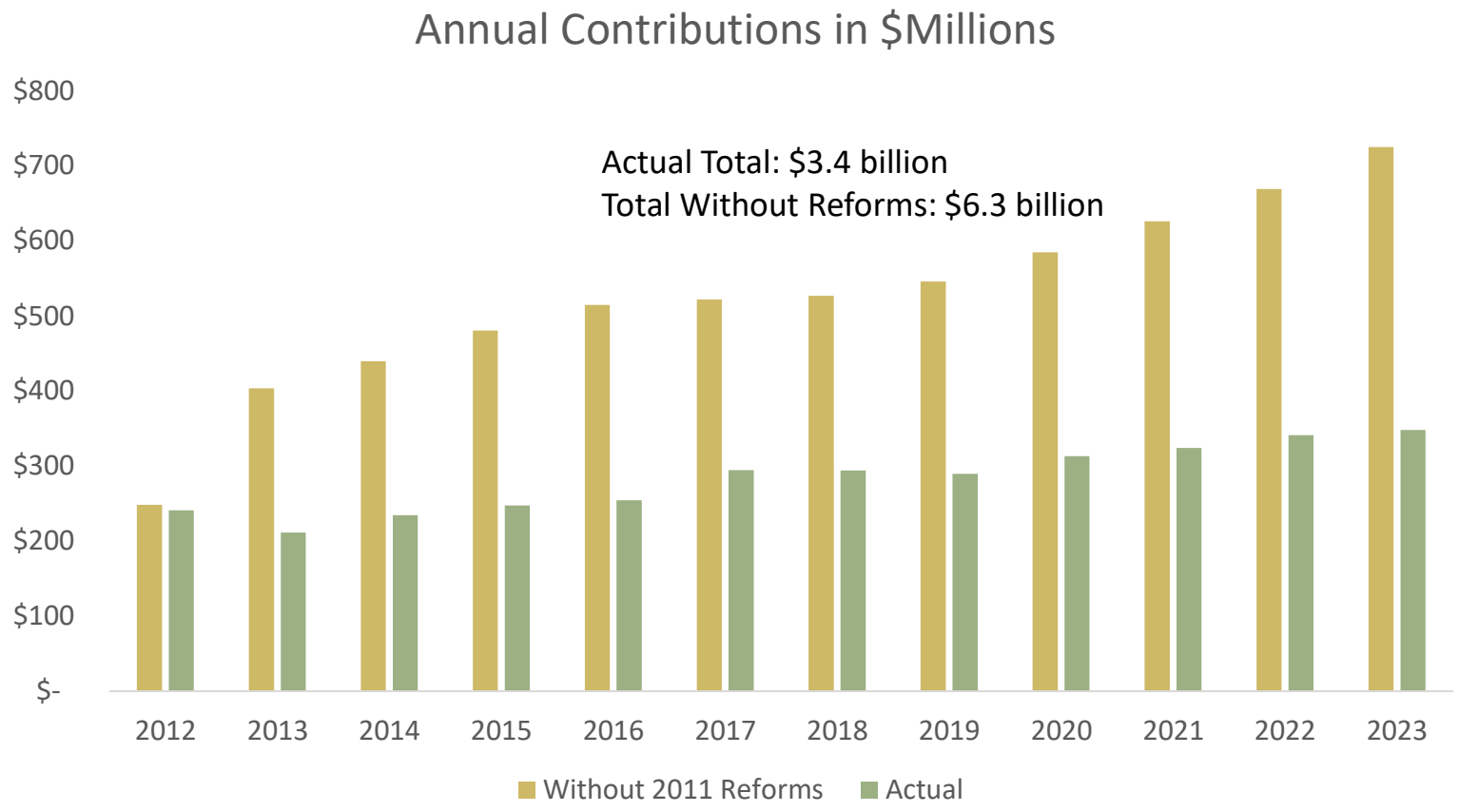



- Just completed an experience study, confirming the current assumption set
- Contributions are projected to grow about 2.1% per year through 2035
  Contributions are projected to grow at 3.2% per year annually if returns are closer to 5%

# Where would the pension plans be without the reform?

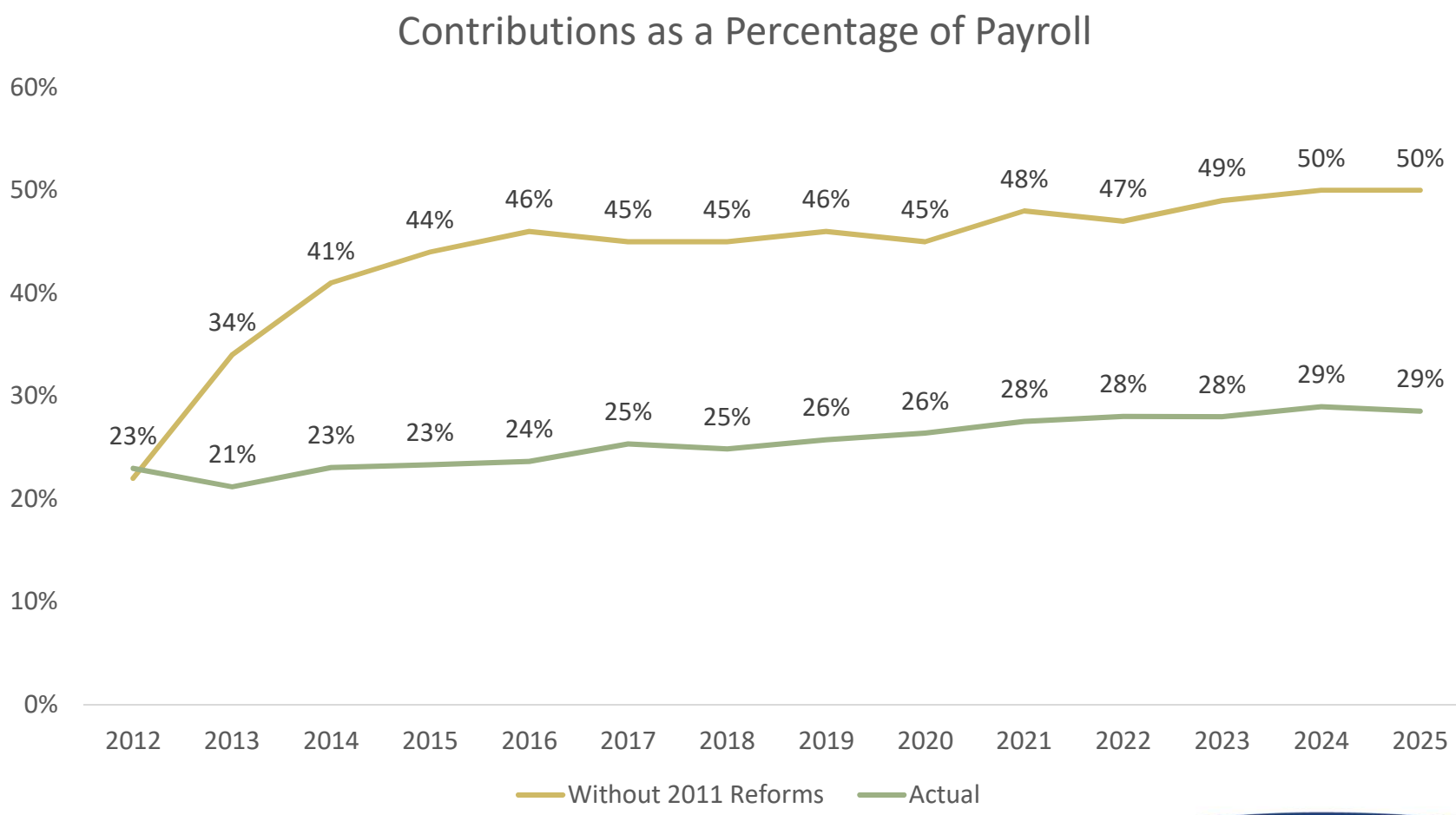
- This scenario incorporates known investment performance and payroll growth since 2011
- Generally, these scenarios also assume
  - Changes to assumptions in 2017 still occurred
  - Actual demographic behaviors, salary increases, etc. occurred
  - No other changes occurred (no other benefit changes, re-amortization, etc)

# Actual Compared to Illustrated without the 2011 Reforms: ERS State Share, State Police, Judges

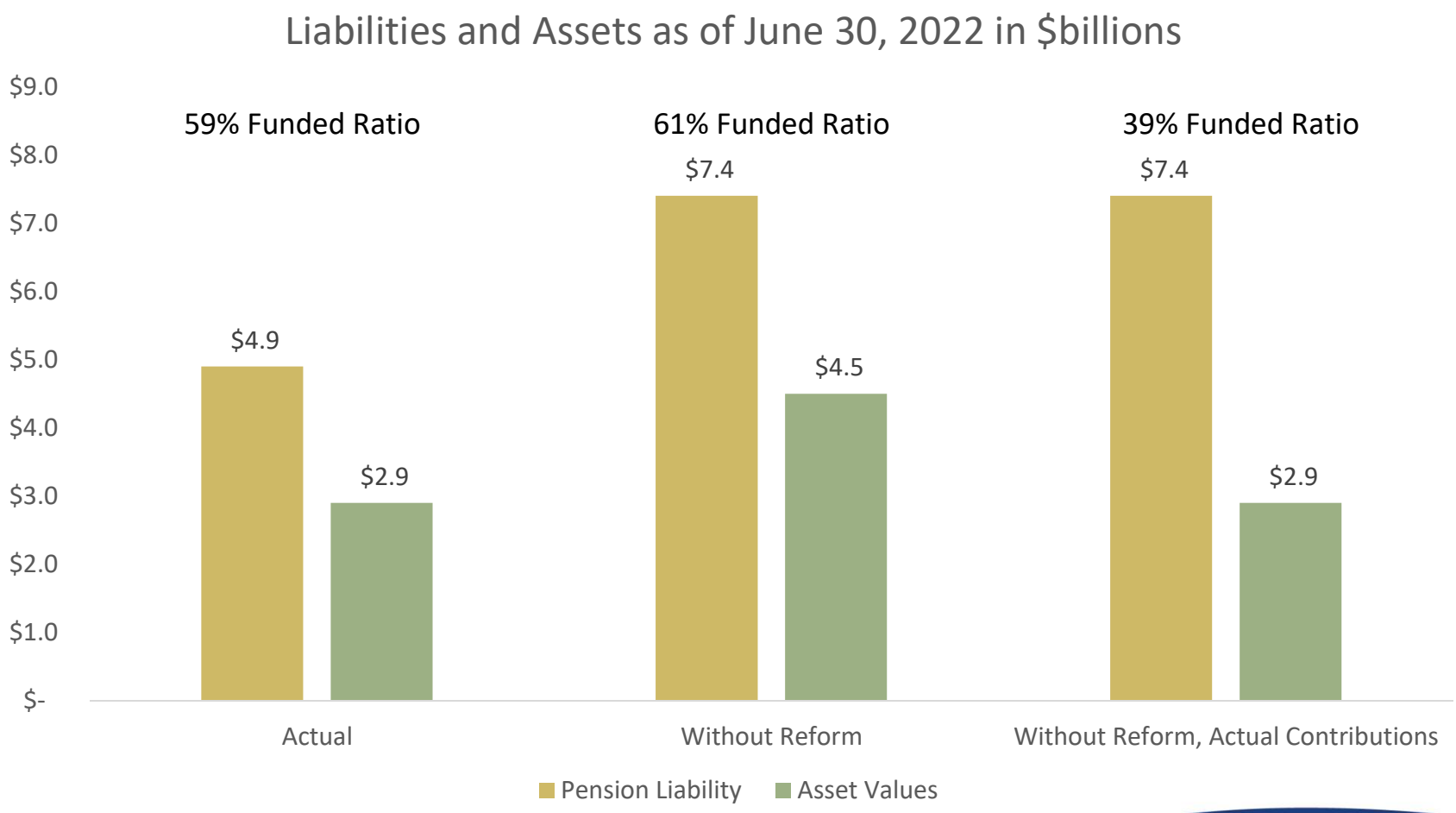



The State has met its Actuarially Determined Requirements each year

# Actual Compared to Illustrated without the 2011 Reforms: State Contribution Rate for State Employees

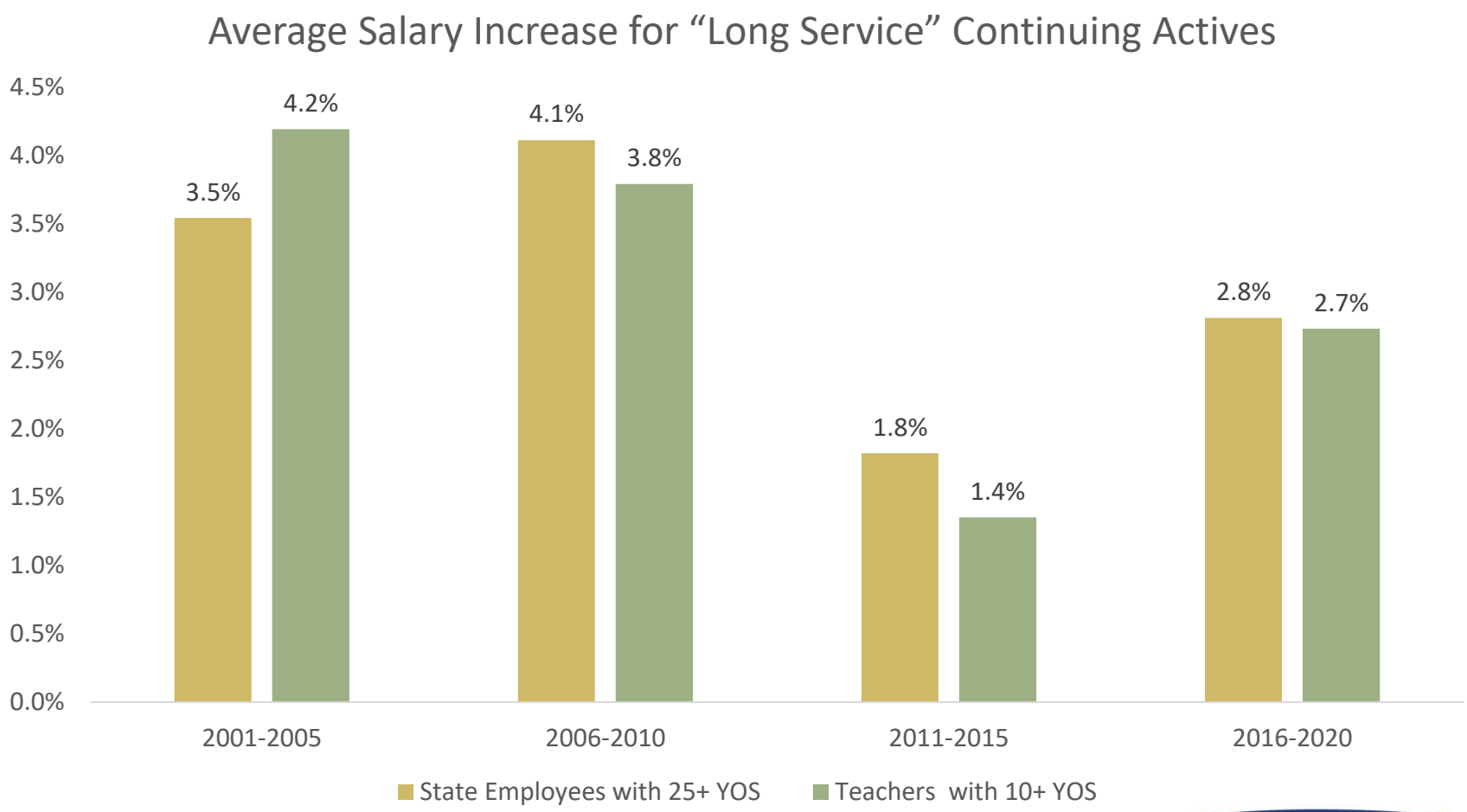


# Actual Liabilities and Assets: With and Without Reforms
# State Employee Plan



# OTHER OBSERVATIONS

# There are likely other factors at play as well, but salary increases have been low since the rise in pension costs



# Turnover

- Turnover has also been higher for most of the covered groups
- At least some of this could be because of the pension reform, as the previous benefit structure did provide a strong incentive to remain with a covered employer
- However, there are several other factors, including the low salary increases and the change to the medical programs, as well as just an increase in turnover across the whole economy

# Salary Experience/Turnover

- Hypothetical: What would salary increases have been if reform had not occurred and pension contributions were 50-60% higher than they were?
- And if there had been almost no salary increases the last decade, what would the turnover look like?

# The Defined Contribution Accounts have performed well to provide supplemental income

- Annualized returns from 7/1/12 through 9/30/23 for the target date funds:
  - 2025: 6.8%
  - 2035: 8.0%
  - 2045: 8.8%
  - 2055: 8.9%
- The median balance for members who have been active since 2012 is $67,700, with a range of $37,700 to $100,700
  - 1 standard deviation

# Summary

- The reform did accomplish what was intended:
  - There have been no further cuts to benefits since the reform
  - Actual contributions have been very close to projected
- Cost of living increases have been suspended and are expected to continue to be until 2031
  - This was and continues to be the source of most of the savings
- The current structure was designed to share risk, not lower the expected overall benefit provided
  - The new structure provides a benefit in line with industry best practices for a career employees

# Important to remember as the commission performs its tasks and makes it recommendations

- The actuarial funding equation is pretty simple:

$$C + I = B$$

  - Where:
    - C = Contributions
    - I = Investment Earnings
    - B = Benefits