**MINUTES OF THE RHODE ISLAND PENSION ADVISORY WORKING GROUP**

**DATE: 17 January 2024**

**Chair George Nee called this meeting to order at 4:07 p.m.**

Pension Advisory Working Group members present:

George Nee, Co-Chair

Ernie Almonte

Eric Atwater

Patrick Crowley

Thomas Huestis

Laura Quinby

Edinaldo Tebaldi

Jonathan Womer

Pension Advisory Working Group members absent:

Michael DiBiase

John P. Maguire

Rhode Island Office of the General Treasurer staff present:

Wilder Arboleda

Eileen Cheng

Robert Craven

Frank Karpinski

Kevin Li

Frank Quinn

**A quorum being present, the Working Group considered the minutes of the 14 December 2023 meeting of the Rhode Island Pension Advisory Working Group.**

On a motion duly made by Mr. Crowley and seconded by Mr. Almonte, it was:

VOTED: THAT

The Pension Advisory Working Group adopt the minutes of the 14 December 2023 meeting.

VOTE: 8 members voted in the affirmative by voice vote, 0 members voted in the negative.

YEAS: George Nee, Ernie Almonte, Eric Atwater, Patrick Crowley, Thomas Huestis, Laura Quinby, Edinaldo Tebaldi, and Jonathan Womer.

NAYS: 0

ABSTAINS: 0

**Chair Nee called Frank Quinn, Director of Debt Management for the Rhode Island Office of the General Treasurer.**

Mr. Quinn provided an overview of the 2023 Debt Affordability Study (the “Study”). Prepared bi-annually, the Debt Affordability Study provides an overview of State debt and pension liabilities, and post-employment liabilities of the State, municipalities and quasi-public agencies of the State. As defined in the Study, debt affordability refers to the State’s ability to repay all its obligations based on the strength of its revenue streams and the capacity of the underlying population to afford the cost of borrowing. Maintaining an appropriate level of debt affordability is crucial for ensuring long-term fiscal sustainability and economic competitiveness.

Pension liabilities contractually or statutorily promised to public employees represent a significant long-term liability of State and municipal debt. As of June 30, 2023, the State had approximately $2.93 billion of unfunded actuarial accrued liability in connection with its four pension programs.

Director Quinn testified that ratings agencies have taken a favorable view of the State’s debt management practices in recent years. Fitch Ratings, for example, recently upgraded the State’s outlook from ‘Stable’ to ‘Positive.’ Continued responsible management is likely to be met with positive ratings actions in the future. A state’s credit rating has a direct impact on Rhode Island’s ability to borrow and the cost of borrowing.

**Chair Nee then called Andrew Nota, Town Manager for the Town of East Greenwich and Vice-President of the Rhode Island League of Cities and Towns to offer testimony on behalf of the League.**

Manager Nota testified to the League of Cities and Towns’ overarching desire to maintain a healthy and sustainable pension system. This is achieved through a careful balance of sustainable funding and responsible management that is mindful of past mistakes and mitigates the need for future reform.

Manager Nota recommended a prohibition on benefit expansion until further growth is made relative to the target funded ratio. Relatedly, Manager Nota recommended the State maintain the 80% target ratio in the interests of long-term sustainability of the system and its ability to support outstanding obligations.

To the extent the Working Group considers benefit adjustments, Manager Nota recommended any such changes are made in light of recognized benefit formulas in order to control costs and ensure financial feasibility.

To increase funding, Manager Nota recommended the Working Group evaluate alternative funding sources such as a dedicated tax supported funding source, a major multi-year investment by the State, or a hybrid model involving both alternative and traditional funding sources.

**Chair Nee then called David Draine of Pew Charitable Trust.**

Mr. Draine offered testimony concerning trends in public pensions, practices in successful pension systems, and an assessment of Rhode Island’s pension system.

Public system pension plans across the United States were approximately 71% funded in 2022, having largely recovered from losses related to the 2008 financial crisis. As of 2021, only six states maintained a lower funded ratio than Rhode Island.

Pew further assessed the share of states sufficiently funding their pension system to maintain stable funding levels (i.e. to cover the cost of new benefits and expected increases in unfunded liability). In a state with stable or positive amortization, pension debt will either stay the same or shrink over time. States below this threshold would expect to see unfunded liabilities grow. In 2021, 29 states had a positive or stable amortization, compared to just 17 in 2014. Rhode Island maintained a negative amortization in 2014, which has since been improved to positive.

Policymakers have largely responded to risk and investment losses from the Great Recession through plan design. Pure Defined Contribution (“DC”) plans are relatively rare in state government. Most states have some form of Defined Benefit (“DB”) plan. Indeed, the majority of states – Rhode Island included – maintain a hybrid DC/DB model. Some states also have integrated risk sharing tools into their DB framework.

Concerning long-term sustainability, Mr. Draine testified that Pew uses three metrics:

1. Solvency, measured by whether the operating cash flow ratio is below - 5%;
2. Debt reduction, based on whether employer contributions are enough to keep the funding gap stable or to pay down pension debt; and
3. Cost predictability, based on the range of employer contribution rates.

Rhode Island has improved on fiscal sustainability since RIRSA’s implementation. The State is now meeting thresholds for fiscal sustainability by paying down pension debt and managing cash flow. Rhode Island maintained a - 6.5% operating cash flow ratio in 2014 – below early the warning threshold articulated above – which increased to - 4.1% by 2021, significant improvement that signifies system stability is less dependent on investment returns. The State likewise fell short of Pew’s net amortization benchmark in 2014 with - 3%. That has since increased to 3% in 2021. Due to increased stability, Rhode Island has seen the funded ratio slowly begin to improve over the last decade.

From the retiree perspective, Pew looks to the following as a metric of retirement security:

1. The replacement income ratio, defined as the percent of a worker’s pre-retirement take-home pay covered by their combined income from a state or city retirement plan benefit plus Social Security; and
2. The retirement savings rate, defined as the level of savings, expressed as a percent of annual salary, that an employee can withdraw from their pension fund when leaving employment prior to reaching retirement eligibility.

In terms of replacement income, Mr. Draine testified to a significant difference depending on whether an individual receives Social Security. For a new hire participating in Social Security, Pew expects the DC and DB benefit will replace about 60% of their final pay. Including Social Security, that increases to over 80% of final pay. Adjusted for take home pay, a career employee can expect to receive just over 100% of their final pay in retirement. By comparison, those not participating in Social Security can expect under 80% of their final pay after adjusting for take home pay, despite increased contributions to the DC plan in their working years.

In terms of savings rate, Rhode Island ranks among the top third of public system plans. The majority of states (including Rhode Island) fall short of recommended savings rates of about 10 to 12% combined from employer and employee contributions.

Cost of living adjustments (“COLAs”) are also a significant consideration relative to retirement income. Following the Great Recession, many states either changed COLA practices or had policies in place that automatically adjusted COLAs in response to economic downturn. Before RIRSA, the 3% automatic COLA was more than sufficient to account for inflation. After the reform, inflation started to outpace benefits, most significantly in the past few years. Rhode Island is not unique in this regard. Ohio teachers have followed a strikingly similar pattern. Before the Great Recession, Ohio did not have policies in place for economic downturn. Following the financial crisis, policymakers froze COLAs to restore actuarial balance. Ohio does not have a formal policy as to when COLAs will be reinstated. Mr. Draine testified that re-instating COLAs rather than waiting until the 80% funded threshold would add to liabilities and to risk. Thus, any consideration of changes to COLAs should include an assessment of both risk and cost.

In summation, Mr. Draine recommended policymakers considering how to balance retirement security, fiscal sustainability, and intergenerational equity consider:

1. The increased liability associated with any benefit enhancement, and the increased contributions necessary to offset any such enhancement;
2. The increase in the risk to plan funding and employer budgets associated with any benefit change; and
3. Whether such risks can be addressed using variable benefit provisions or other risk sharing tools.

In response to an inquiry from Mr. Almonte, Mr. Draine testified that – while inflation was expected in 2011 – the degree of inflation over the past several years was unanticipated.

In response to an inquiry form Mr. Womer, Mr. Draine testified that the mean public pension plan across states was 82% funded.

**Chair Nee then called Dan Doonan of the National Institute for Retirement Security (“NIRS”).**

Mr. Doonan offered testimony concerning worker retention.

Generally, retention has declined across all groups, with one exception: new teachers. This has a variety of implications, including the return on recruitment spending (in terms of years of public service) and the level of experience among public employees. Though pensions generally create a strong financial incentive intended to transform a ‘job into a ‘career,’ Mr. Doonan acknowledged that pensions are not the only factor that may impact worker retention.

Based on data from actuarial experience studies published by the Employees’ Retirement System of Rhode Island (“ERSRI”), Mr. Doonan testified that turnover among state employees has increased since 2004. Whereas 45% of state employees reached 25 years of service based on 2010 experience study data, 2022 experience study data indicates that only 29% of employees will reach that same benchmark. Among other groups, 2022 turnover experience has been the highest among the five most recent experience studies, with the exception of new teachers. Mr. Doonan testified that external factors – such as the recession and COVID-19 pandemic – may have impacted these results but higher turnover has been relatively consistent.

In 2023, ERSRI and the Municipal Employees’ Retirement System (“MERS”) had a significant number of new members over the age of 45. This figure was 30% for state employees, 36.5% for general municipal employees, and 28.9% for teachers. The relative age of an employee at the time of hire has a direct impact on an that employee’s retirement benefit. Interest accrued on larger account balances from early year contributions account for a significant portion of a career employee’s retirement benefit. The same cannot be said for mid-career hires (those hired at or around age 45), where interest growth does not happen over as many years and is therefore likely to be much lower at the time of retirement.

Relative to the hybrid DC/DB plan implemented in 2011, Mr. Doonan testified that DC plans are most effective when employees begin saving young and do not cash out, while DB plans are most beneficial for long-service workers, and mid-career and late hires.

Mr. Doonan emphasized that increased pension discipline in Rhode Island is important and is starting to show results, so any change must be mindful of the State’s economic abilities. Mr. Doonan also addressed the plan’s negative cash flow. In a system with negative cash flow, the contributions into the system are less than the benefits paid out each year (exclusive of investment returns). Between 2012 and 2013, the State experienced a large increase in negative cash flow when the DC plan opened (thereby diverting money from the DB plan to the DC plan). While that has been rectified with higher contributions – balancing cash flow – the plan looks more mature than it is from a cash flow perspective.

**Chair Nee then called on Mr. Womer, whose Office prepared a summary of authorized and filled positions in state government in response to an earlier inquiry made by the Working Group.**

Mr. Womer explained that the line graph in the document presented indicates full time equivalent (“FTE”) authorizations relative to filled positions over the past 20 years. An FTE authorization is a cap set by the legislature on the number of positions.

**The Working Group then considered a Memorandum prepared by the Office of the General Treasurer summarizing and explaining options for consideration of the Working Group.**

The Working Group agreed to present the Memorandum to the state actuary in its entirety, thereby directing the state actuary to assess the cost associated with each option (to the extent there is an actuarial cost). To assist the actuary in determining a cost for each option – and at the suggestion of Mr. Crowley – the Working Group directed the actuary to use July 1, 2024, as the effective date for each option.

**Chair Nee then called for a motion to adjourn the meeting.**

On a motion duly made by Mr. Nee and seconded by Mr. Almonte, it was:

VOTED: THAT

The Pension Advisory Working Group adjourn the meeting of 17 January 2024.

VOTE: 8 members voted in the affirmative by voice vote and 0 members voted in the negative.

YEAS: George Nee, Ernie Almonte, Eric Atwater, Patrick Crowley, Thomas Huestis, Laura Quinby, Edinaldo Tebaldi, and Jonathan Womer.

NAYS: 0

ABSTAINS: 0

The meeting adjourned at 6:29 p.m.