

RIPEC

NEWS RELEASE

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PRESS RELEASE

Pensions: The State of Rhode Island's Pension System

On Monday, February 16, 2009, the Rhode Island Public Expenditure Council (RIPEC) will release its analysis of the Rhode Island State Pension System. The report analyzes the current state of Rhode Island's pension system and compares it to other New England state systems and the nation. The report will be posted on RIPEC's website at: www.ripec.org

The report finds that:

- The estimated funding ratio for the Employee's Retirement System of Rhode Island (ERSRI) is 57.5 percent while the Rhode Island teacher pension has a funded ratio of 55.4 percent. Studies of major pension plans in the U.S. indicate the aggregate funding ratio is 86.0 percent;
- Combined, Rhode Island's State employee and teacher pensions have a net estimated unfunded liability of approximately \$5.0 billion;
- The State's annual required contribution for pensions for State employees and teachers increased from 4.6 percent of general revenue expenditures in FY 1997 to 5.9 percent in FY 2007;
- Based on a recent comparison among New England states, Rhode Island's State employee pension system (Schedule A) appears to be more generous due to the availability of early age retirement without penalty and the program's 3.0 percent COLA that is applied to years of service;
- Even with changes effective July 1, 2005, Schedule B participants still receive the 2nd highest pension for retirees in New England, assuming retirement at age 60 with 30 years of service, and a final average salary of \$70,000;
- Based on the June 30, 2007 valuation of the retiree pension systems for Rhode Island, there are approximately 12,600 active state employees, with an average age of 48.2 years. There are nearly 9,200 State employee retirees and beneficiaries with an average age of 72.7. The active to retiree ratio is estimated at 1.24;

- There are approximately 14,150 active teachers, with an average age of 44.6 years. There are nearly 9,100 teacher retirees and beneficiaries, with an average age of 74.8. The active to retiree ratio is estimated at 1.55.
- It is expected that these ratios will continue to degrade as the rates of increase in retired members continue to outpace the rate of growth in active members, particularly in the teacher ranks; and
- As of June 30, 2007, the average state employee pension was approximately \$23,781, and the average teacher pension was approximately \$41,340.

Rhode Island's Pension System Summary Data		
<u>Unfunded Liability (\$ million, as of June 30, 2007)</u>		
State Employees	\$1,839.5	
Teachers	3,012.1	
Total Unfunded Liability	\$4,851.6	
<u>Funding Ratio (as of June 30, 2007)</u>		
US Aggregate	86.0%	
ERS	57.5%	
Teachers	55.4%	
State Police	76.1%	
Judges	83.8%	
<u>ARC*</u>	1997	2007
	Amount (\$ million)	
State Employees	\$45.4	\$118.3
Teachers (State Share)	34.9	70.5
Total State Contribution	\$80.3	\$188.8
As Percent of Gen Rev Exp	4.6%	5.9%
*ARC = Annual Required Contribution by State		

To address the growing amount the State contributes to pensions, to mitigate the risks inherent in the current pension system and to meet the impact of the economic downturn, RIPEC recommends that State Government seek alternative ways to reduce cost and minimize risk. This is a necessary step to begin to control the rate of growth of pension cost and to reduce the unfunded liability.

Governor Carcieri has proposed several reforms to the current pension system for State and municipal employees and teachers. These reforms propose to reduce both the unfunded liability and the growth in operating budget expenses related to pensions. The pension reform is based upon five components:

1. Eliminating the cost-of-living adjustments (COLA) for State employees, teachers, judges and State Police who retire after April 1, 2009;
2. Establishing a minimum retirement age of 59 for those who retire after April 1, 2009;
3. Changing the calculation of the retirement benefit for State Police who retire after April 1, 2009;
4. Changing the maximum benefit and establishing reporting criteria for State employees and teachers who retire on accidental disability after April 1, 2009; and
5. Reducing the actuarially determined employer retirement contribution.

The Pension Review Committee formed by the House of Representatives has asked the Actuary to review additional reforms, such as providing for COLAs to go into effect only when retirees reach the age of 65, establishing a minimum retirement age of 59 and considering a similar pension system as the Federal Employees Retirement System which is a hybrid pension plan.

These, and other reforms are intended to address how to reduce cost and the unfunded liability and ought to be seriously considered. Without the reforms, State and local governments will not be able to control one of the major budget drivers they face in the coming years.

While some of the proposed reforms will address reducing mandatory cost and the unfunded liability, there is still a need to take the risk out of providing a defined benefit pension system. State and local governments assume all the risk inherent in the provision of a defined benefit plan including investment risk and the actuarial assumptions. If the assumptions are not met, State and local governments must then increase funding as was shown in the recent five-year review of the State's pension system.

RIPEC recommends that the State consider a defined contribution plan where the plan is structured around using the "normal cost" of pensions as the funding mechanism. The unfunded portion of the Annual Required Contributions (ARC) would still be an issue, but this would be the case with or without a defined contribution plan. A hybrid plan would also mitigate several of the risk issues.

RIPEC also suggests consideration of the impact these proposed reforms will have on employment within the State. This will be the second round of pension reform over the last several years. Coupled with the recent healthcare changes these adjustments to employee benefits have, and will continue to have, an effect on the composition of the State workforce. For example, any reform of the pension system should also evaluate the effect on State employees and on the State's ability to deliver services. The concept of vesting, and its impact upon employees of the State as they make employment decisions, needs to be carefully considered.

In addition, any changes to the pension system, while considering the affordability and sustainability of the State's pension fund, should include an evaluation of the overall impact on the State's pension contribution in out-years. Any reduction in workforce produces payroll savings to the State. However, when payroll significantly declines, as it has for State employees since June 30, 2007, the scheduled contribution rate does not produce the expected amortization payments. This shortfall in payments must then be funded in the future.