JANUARY 2017

Employees' Retirement System of the State of Rhode Island

Fiscal Year Ended June 30, 2016

We completed an audit of the fiscal 2016 financial statements for the **Employees' Retirement System of the State of Rhode Island** (the Retirement System). We concluded that the financial statements of the Retirement System present fairly, in all material respects, the fiduciary net position of the System's plans as of June 30, 2016 and the changes in fiduciary net position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The audit encompassed (1) the six defined benefit pension plans administered by the Retirement System – i.e., separate plans for state employees and teachers, the teachers' survivors benefit program, state police, two plans covering judges, and participating municipal employees, and (2) the defined contribution plan. These plans covered more than 68,000 members.

Net position of the Retirement System decreased by $301 million during fiscal 2016 to $8.1 billion at June 30, 2016. The time weighted rate of return during the fiscal year was -0.27% (compared to 2.22% during the prior fiscal year). The net investment loss within the pooled investment trust was $8.3 million (compared to net investment income of $199.6 million during fiscal year 2015).

Pension benefits paid to retirees and beneficiaries from the defined benefit plans during fiscal 2016 totaled $932 million including $23.3 million in one-time stipends and a benefit adjustment related to settlement of litigation challenging pension reforms enacted in prior years.

Employee and employer contributions totaled more than $564.6 million to all the defined benefit plans.

Amounts accumulated in the defined contribution plan totaled $514 million at June 30, 2016. The majority of defined contribution plan assets (92%) are held in target date retirement fund investments.

Employer and employee contributions to the defined contribution plan were $109.5 million during fiscal 2016, a decrease of $20.2 million. Active employees with more than 20 years of service at July 1, 2012 no longer contributed to the defined contribution plan effective July 1, 2015. Distributions from the defined contribution plan totaled $9.2 million. Investment gains within the defined contribution plan totaled $4.3 million.

The accounting measures of the net pension liability (GASB Statement No. 67) used for financial reporting differ from the measures 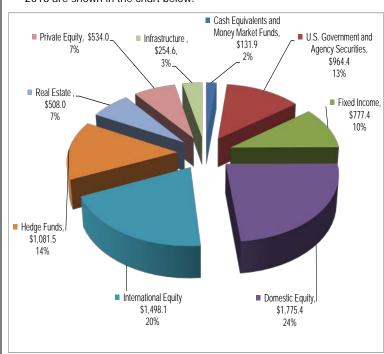used to determine actuarially determined contribution amounts for funding purposes. Employers participating in the System's plans report the net pension liability (asset), or their proportionate share, on their government-wide financial statements as required by GASB Statement No. 68 - *Accounting and Financial Reporting for Pensions.*

The net pension liability of each plan is shown in the table on the following page as of June 30, 2016. The Teachers' Survivors Benefit Plan (TSB) has a net pension asset - net position exceeds the total pension liability.

The pension liability for all plans except the RIJRFT was determined using the System's investment return assumption of 7.5%. The RIJRFT used a municipal bond index rate of 2.85%.

The System's fiscal 2016 financial statements also include disclosures related to the money-weighted return on investments for each plan, the components of the change in the net pension liability (asset), and the sensitivity of the determination of the net pension liability (asset) by a change in investment return assumption of +1/-1%. The real return assumption for each asset class within the pooled investment trust is disclosed as support for the System's overall investment return assumption of 7.5%.

The assets held within the pooled investment trust at June 30, 2016 are shown in the chart below:

- Private Equity, $534.0 — 7%
- Infrastructure, $254.6 — 3%
- Cash Equivalents and Money Market Funds, $131.9 — 2%
- U.S. Government and Agency Securities, $964.4 — 13%
- Fixed Income, $777.4 — 10%
- Real Estate, $508.0 — 7%
- Hedge Funds, $1,081.5 — 14%
- International Equity $1,498.1 — 20%
- Domestic Equity, $1,775.4 — 24%

At its October 2016 meeting, the State Investment Commission voted to redeem the investment in seven hedge funds totaling approximately $586 million. The action was taken as part of an overall asset allocation review. Redemptions are expected to

commence in February 2017 and continue through December 2017 consistent with hedge fund contract redemption terms.

In September 2016, pursuant to a law enacted by the General Assembly, the State made the initial deposit of $15 million to a new trust, under the governance of the Employees' Retirement System of Rhode Island, to fund and pay benefits that were earned under the provisions of the State Police Non-Contributory Retirement Plan. These funds were received by the State as a result of an asset forfeiture that stemmed from a multi-law enforcement agency investigation of Google, Inc. The legislation also calls for the State to make payments into the Trust to amortize the remaining unfunded liability over a period of 18 years.

Various legal challenges to enacted pension reforms initiated in recent years were settled in 2015. To carry out the settlement, the Rhode Island General Assembly passed legislation amending the Rhode Island Retirement Security Act (RIRSA), which had been enacted into law in 2011. This legislation was enacted into law on June 30, 2015 and became generally effective July 1, 2015 (New RIRSA). On July 8, 2015, the Court entered final judgment.

The audit report is available on our website - www.oag.ri.gov or by calling the office at 401.222.2435.

Plan	Total pension liability	Plan fiduciary net position	Employers' net pension liability (asset)	Plan fiduciary net position as a % of the total pension liability
ERS				
State employees	$ 4,410,709,110	$ 2,288,446,139	$ 2,122,262,971	51.9%
Teachers	6,494,164,064	3,510,586,538	2,983,577,526	54.1%
TSB	209,118,520	286,485,057	(77,366,537)	137.0%
State Police	125,557,246	116,316,582	9,240,664	92.6%
JRBT	66,951,367	60,418,485	6,532,882	90.2%
RIJRFT	21,631,112	533,525	21,097,587	2.5%
MERS				
General employees	1,143,357,181	901,383,814	241,973,367	78.8%
Police and fire	601,947,331	456,492,511	145,454,820	75.8%