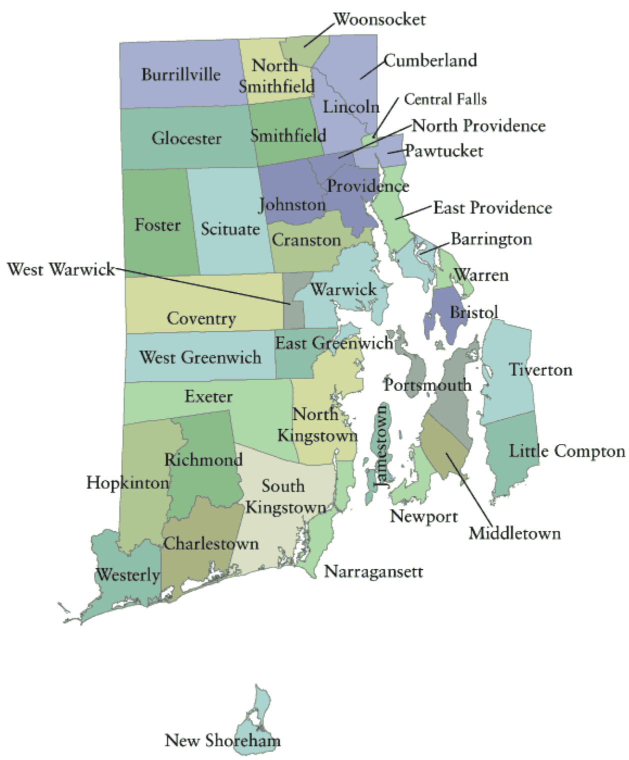
Status of Pension and OPEB

Plans Administered by

Rhode Island Municipalities

March 2010



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STATE of RHODE ISLAND and PROVIDENCE PLANTATIONS

GENERAL ASSEMBLY

OFFICE of the AUDITOR GENERAL

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March 9, 2010

JOINT COMMITTEE ON LEGISLATIVE SERVICES:

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Senator M. Teresa Paiva-Weed
Senator Dennis L. Algiere
Representative Nicholas A. Mattiello
Representative Robert A. Watson

We have completed a review of the status of defined benefit pension and other post-employment benefit (OPEB) plans administered by Rhode Island municipalities. This report is an update of our previous report *Status of Pension Plans Administered by Rhode Island Municipalities* issued in July 2007 and also includes our first statewide assessment of the status of other post-employment benefit plans offered by municipalities. Our review is a natural extension of our oversight responsibilities with respect to Rhode Island municipalities.

Our report is included herein as outlined in the Table of Contents and includes recommendations to improve the funded status of pension and OPEB plans administered by Rhode Island municipalities and also highlights matters which we believe warrant further legislative study and deliberation.

Sincerely,

Dennis E. Hoyle, CPA
Acting Auditor General

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Status of Pension and OPEB Plans
Administered by Rhode Island Municipalities
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Many of the pension plans administered by Rhode Island municipalities have deteriorated further since our last report in July 2007. In several cases, municipalities have continued to contribute less than 100% of the annual required contributions and funded ratios have continued to decline; thereby, leaving some of these plans in perilous condition. At $2.4 billion, the newly disclosed unfunded liability for other post-employment benefits provided by municipalities ("OPEB"– generally retiree healthcare) overshadows the collective unfunded liability for all locally administered pension plans which now totals $1.9 billion.

The number of pension plans considered to be at risk has grown from 21 to 23 and their collective funded ratio decreased from 45%, as reported in July 2007, to 43% currently. Of the 23 (out of 36) locally administered pension plans considered to be at risk, seven were considered most at risk because the plans were significantly underfunded and annual contributions were significantly less than actuarially determined amounts. For twelve other plans, annual contributions were more than 80% of annual required amounts; however, the plans were still significantly underfunded. Four additional plans were considered at risk; despite a funded ratio greater than 60%, annual contributions were generally declining over a multi-year period. The collective unfunded liability for locally administered pension plans has increased $300 million from $1.6 billion in July 2007.

Pension plans administered by Rhode Island municipalities are of concern because so many are considerably underfunded. The principal concern is ensuring that adequate funds will be available to meet benefit payments promised to retirees. Of equal importance is the negative impact these self-administered plans are having on the overall financial health of communities when not properly funded. When pension and OPEB plans are chronically underfunded, the eventual costs to fund the plans become significantly larger and divert resources from other programs and initiatives.

Many municipalities are challenged to contribute at required levels, a necessary component to eventually reduce unfunded liabilities. Improving the funded status of these plans presents a significant hurdle to many communities that are already challenged to meet their obligations within state mandated property tax limits and reductions in state aid to municipalities. Recent investment losses have further eroded the funded ratios of the plans although the full impact of those market conditions has yet to be recognized in actuarial valuations of the plans. Oversight measures to increase the percentage of annual required contributions actually made to plans have not resulted in a significant increase in contributions. No locally administered plans have merged into the state-administered Municipal Employees' Retirement System since our prior report.

Governmental employers must now recognize OPEB costs on an actuarial basis. These costs are almost totally unfunded - the collective unfunded liability for OPEB benefits is $2.4 billion and assets to cover less than 1% of the actuarial accrued liability have been set aside.

The collective annual required contributions (for pensions) for all municipalities was approximately $295 million for fiscal 2009 of which $161 million related to locally-administered plans. The annual required contribution for OPEB plans was $190 million. The total annual cost to municipalities (if 100% of the required contributions were made) was $485 million. The amount actually funded was approximately $367 million.

For nine communities, the annual required contribution for pensions and OPEB (if 100% were made) represents 25% or more of the community's fiscal 2009 property tax levy – a significant and likely unsustainable burden. In Central Falls, Pawtucket, and Johnston the annual required contributions (for pensions and OPEB) were 57%, 59%, and 47%, respectively, of their annual property tax levy.

There are currently no state administered OPEB plans for municipalities – all municipal OPEB plans are locally administered. Consistent with the conclusions outlined herein that locally administered pension plans are at risk, locally administered OPEB plans should likely be viewed in the same light. An opportunity exists to restructure plan design and benefit delivery before each community creates a trust and begins to accumulate assets to fund future benefits.

Underfunded pension and OPEB plans are not unique to Rhode Island. The issues associated with defined benefit plans–both public and private–have received significant attention in light of increasing actuarial liabilities for future benefits. This is driven in large part by employees retiring earlier and living longer as well as recent investment losses.

Various structural issues contribute to or facilitate the poorly funded status of many locally-administered plans. Clearly, local administration of the plans allows flexibility in defining the benefit structure of the plan and also the timing and actual amounts contributed to the plan. In many instances, that flexibility has resulted in generous benefits and failure to make annual required contributions. Additionally, local governments typically have a short-term annual budget process perspective which is often inconsistent with the long-term perspective required of pension plan stewards. These factors directly impact the poorly funded status of the plans.

In contrast, all Rhode Island municipalities are making 100% of their annual required contribution for teachers to the state administered Employees' Retirement System. Similarly, all Rhode Island municipalities that participate in the Municipal Employees' Retirement System (MERS) are making 100% of their annual required contribution and are adhering to the established benefit structure outlined in the State's General Laws. The MERS plan has a funded ratio of 93%. In these instances, the municipality must fund required amounts – the General Laws allow for offset of state aid to local governments if the municipality is delinquent in making required pension contributions to the State administered pension plans. The same fiscal discipline is not forced upon a municipality with regard to its locally administered pension plan.

Failure to make annual required contributions can have a profound effect on pension costs for the municipality and ultimately the taxpayer. For example, the annual required contribution for the City of Cranston's Police and Fire Employees Retirement System was $20.1 million for fiscal 2009. This plan, which covers just 70 active members and 426 retirees for a total of 496 individuals, has been chronically underfunded (funded ratio of 15.1%). In contrast, the <u>aggregate</u> annual required contribution for <u>all</u> participating entities in the Municipal Employees' Retirement System (MERS) was $33.5 million covering a total of 14,667 individuals (active and retirees). The wide disparity in relative annual contributions results from failure to contribute required amounts in the past and benefits that are more generous than those afforded retirees under the MERS. The unfunded liability under the Cranston Police and Fire plan is estimated at an average $492,413 per member compared to $6,253 per member under the State-administered MERS plan.

Similarly, the fiscal 2009 annual required contribution to the City of Providence's pension plan for its employees (excluding teachers) was $48.5 million of which the City made 100% of the required contribution. The composite employer contribution rate (different rates are actually applied to different groups of employees - e.g., police, fire, general) was 41.95% of payroll. Within the rate, only 5.81% related to normal or current service costs and 36.14% related to amortization of the unfunded liability and interest thereon.

Due to their size, locally administered plans are at a disadvantage in investing plan assets with the aim of maximizing returns yet reducing risk exposure through diversification. The smaller size of the investment portfolios associated with the self-administered plans makes it more difficult to fully participate in all types of investment options. With some exceptions, investment returns of the self-administered plans are generally less than the returns earned by the State retirement system.

Since fully funding these plans in the near term is unlikely given the current fiscal stress on all municipalities, several control measures and options should be considered and implemented to decrease the risk that these plans (1) will be unable to meet their benefit obligations to retirees, or (2) continue to negatively impact a community's overall fiscal health.

We recommended previously, and continue to recommend, that municipalities take various measures to improve the funded status of their plans and also pursue merging their self-administered plans into the State administered Municipal Employees' Retirement System. Additionally, municipalities should consider alternatives to defined benefit plans (e.g., defined contribution, and "hybrid" plans) for new hires. We also recommend that municipalities adopt a plan to begin funding OPEB liabilities and revise benefits as needed to ensure that OPEB plans are sustainable.

In addition, we identified a number of matters that may warrant further legislative deliberation, including the creation of a pooled investment trust for locally administered pension plans to improve investment performance. We also highlight that the enforcement provisions, contained within an existing statute, that are intended to ensure that municipalities make 100% of their annual required contribution could be enhanced.

Other matters to be considered include implementing (1) incentives to encourage municipalities to merge locally administered pension plans into the Municipal Employees' Retirement System, (2) criteria that would trigger increased State oversight of severely underfunded local pension plans, and (3) a two-tiered benefit structure within the Municipal Employees' Retirement System that is similar to statutory changes recently enacted for the Employees' Retirement System.

Lastly, the State should contemplate what role it may assume in administering either a pooled investment trust for assets accumulated by municipalities to fund their OPEB liabilities or offering a multiple-employer agent OPEB plan to achieve economies of scale and cost savings in providing post-retirement healthcare benefits to municipal employees. This later option would be consistent with (1) the goal of merging locally administered pension plans into the state-administered MERS plan and (2) various initiatives to foster a statewide healthcare contract for teachers and municipal employees with a common health insurer/administrative agent.

OBJECTIVES

The objective of our review was to assess the fiscal health of the various locally-administered pension and other post-employment benefit plans (OPEB) covering Rhode Island municipal employees. The fiscal health of these plans was measured by whether the municipality was consistently making 100% of annual required contributions to the plans, the overall funded status of the plan, and the investment performance of plan assets. We also assessed a community's capacity to meet its annual required contributions by measuring the total annual required contribution for all pension plans the municipality participates in as a percentage of the community's annual property tax levy.

In addition, we assessed the effectiveness of efforts outlined in the general laws to require local governments to make 100% of their annual required contributions. Further, we explored some of the factors that generally contribute to locally administered pension plans being at higher risk than plans administered by the State. For this update report, we have also presented information to conclude whether the status of these locally administered pension plans has improved or worsened since our July 2007 report.

Information reported by Rhode Island's municipalities regarding their costs for post-employment benefits other than pensions (generally health-care for retirees) has only recently been required to be disclosed but should be considered when evaluating the overall fiscal health of a community and the funded status of its obligations for pensions and retiree healthcare to its employees.

Additionally, we outlined options that may be considered to enhance the funded status of locally administered pension and OPEB plans thereby improving the overall fiscal health of the municipality. We have also included an assessment of the implementation status of recommendations included in our previous report for the State's municipalities as well as an update of various matters previously highlighted as matters warranting further legislative deliberation.

Our review was based on various data which is publicly available including the audited annual financial statements of each municipality in Rhode Island and periodic actuarial valuations performed for locally administered pension and OPEB plans. Generally, our review is intended to make an assessment at a common point in time using audited financial data included in the municipality's fiscal 2009 audited financial statements. For communities with a June 30 fiscal year end, those reports were due to our office by December 31, 2009. If any community has obtained an actuarial valuation of its pension plan subsequently, that information has generally not been included herein except as noted.

The current status of any locally administered pension plan may vary from the information presented herein based on investment performance and other factors subsequent to the date of the municipality's most recent audited financial statements.

We have not performed independent tests of the data included in these financial reports, actuarial valuations, or investment performance data which were the bases for our analysis. We have also not compared benefit provisions among the various plans administered by Rhode Island's municipalities.

BACKGROUND

Pension plans of all types continue to receive scrutiny for a variety of reasons including very significant unfunded liabilities, the impact of recent market events on investment performance, debate over defined benefit vs. defined contribution plans and government vs. private sector plans. In general, most plan sponsors struggle to contain escalating pension costs which result from past underfunding of the plans, employees generally retiring earlier and living longer, and the impact of recent investment losses affecting nearly all plans.

Government defined benefit plans have been under particular scrutiny due to the perceived inequality of benefits when compared to private sector plans. In Rhode Island, the state employee and teacher pension plan has been studied in depth resulting in legislative action to modify benefit provisions (2009 session). Further modifications have been proposed in the Governor's fiscal 2010 supplemental and 2011 budget submissions. Proposals to modify the benefit structure of plans within the Municipal Employees' Retirement System (MERS) are also under consideration with the aim of generating cost savings to fiscally stressed municipalities.

Investment performance in the last two years has had a severe impact on the funded status of pension plans and required contributions. The effect is somewhat muted by "smoothed-market" provisions employed by most plans which spread the highs and lows of annual investment performance over a longer period (e.g., five-year smoothing). Due to these smoothed market provisions and the inherent delay between the date actuarial valuations are performed and the period in which employer contributions are made, the impact of recent severe market conditions has not been fully recognized in the funded status of most plans. Arguably, the current funded status of the plans is likely worse than the specific data included herein.

Despite escalating pension costs, some entities have reduced contributions for budgetary reasons; thereby, deferring their obligation to fund the liabilities into the future and creating a much more serious and long-term financial problem. Many plans are severely underfunded which presents the risk that sufficient funds will not be available to meet promised benefits to retirees. It also undermines the overall fiscal health of the plan's sponsor.

In the government environment, the annual cost of providing pension benefits can be a significant portion of the annual operating budget of any municipality. Failure to make annual required contributions to pension plans or invest pension assets prudently can ultimately increase the overall cost to the municipality. Additionally, granting generous benefits without consideration of the long-term costs can have a far-reaching impact on the overall fiscal health of a community.

New governmental accounting standards, which recently became effective, generate further focus and concern as governments are required to measure and disclose the future cost of OPEB (e.g., retiree health care) on an actuarial basis. In actuality, most OPEB plans operate on a pay-as-you-go basis without any accumulation of funds to provide for future benefits. Due to the escalating nature of health-care costs and the time period for which benefits are provided, the costs of such benefit programs are very significant. These unfunded liabilities, although just recently disclosed, deserve the same attention and funding commitment as those accruing from pension benefits.

OVERVIEW OF PENSION and OPEB PLANS COVERING RHODE ISLAND MUNICIPAL EMPLOYEES

Rhode Island municipal employees are covered by a variety of pension plans, some administered by the State, others administered by the municipality, and a few administered by employee unions. While the focus of this report is primarily defined benefit pension plans administered directly by Rhode Island municipalities, it is useful to understand the types of pension plans (defined benefit vs. defined contribution) and the variety of plans covering local public employees.

Defined benefit pension plan – A pension plan having terms that specify the amount of pension benefits to be provided at a future date or after a certain period of time; the amount specified is a function of one or more factors such as age, years of service, and compensation.

Defined contribution plan – A pension plan having terms that specify how contributions to a plan member's account are to be determined, rather than the amount of retirement income the member is to receive. The amounts received by a member will depend only on the amount contributed to the member's account, earnings on investments of those contributions, and forfeitures of contributions made for other members that may be allocated to the member's account.

Source: *Governmental Accounting and Financial Reporting Standards* published by the Governmental Accounting Standards Board

Employees' Retirement System of Rhode Island (ERS) - Teachers

- *Administered by State of Rhode Island*
- Covers local public school teachers
- Total plan assets - $3.7 billion (teachers share – fair value at June 30, 2009)
- Unfunded Actuarial Accrued Liability - $2.7 billion at June 30, 2008 (valuation date)
- Funded ratio – 60.3% at June 30, 2008 (valuation date)

All local school teachers are members of the Employees' Retirement System (ERS) of the State of Rhode Island (pursuant to General Law section 16-16-2). That plan also covers state employees and is administered by the State. The employer contribution to the plan for teachers is shared between the local school district and the State (fiscal 2009 - 8.18% State and 11.89% local for a total employer contribution rate of 20.07% in fiscal 2009). Teachers contribute 9.5% of their salaries. The municipality has no responsibility for administering the plan and its primary obligation is to make annual required contributions. Separate actuarial valuations are not performed for each school district – all districts contribute at the same employer contribution rate which is shared with the State.

Municipal Employees' Retirement System of Rhode Island (MERS)

- *Administered by State of Rhode Island*
- Covers various categories of municipal employees - general, police and fire
- Total plan assets – $892 million - fair value at June 30, 2009
- Unfunded Actuarial Accrued Liability - $91.7 million at June 30, 2008 (valuation date)
- Funded ratio – 92.8% at June 30, 2008 (valuation date)

Some municipal employees participate in the Municipal Employees' Retirement System (MERS) of the State of Rhode Island which is administered by the State. That system is a voluntary multiple-employer agent plan. The State acts as administrative agent but assumes no funding responsibility. A municipality may have multiple units covering specific groups of employees (e.g., police, fire, general employees) -- separate actuarial valuations are performed for each participating entity. The municipality has no responsibility for administering the plan but is required to make annual required contributions as determined by the actuary specifically for that unit.

Some municipal employees are covered by pension plans administered by their employee union. In these instances the municipality's obligation is solely to make annual required employer contributions.

> *Various Locally Administered Pension Plans*
>
> - *Administered by local governments*
> - Covers various categories of municipal employees - general, police and fire
> - Total plan assets – $1.4 billion (as of most recent data available in FY 2009 audit reports)
> - Unfunded Actuarial Accrued Liability - $1.9 billion (as of most recent audit reports)
> - Collective funded ratio – 43% (as of the most recent information included in fiscal 2009 audit reports)

Many municipalities have established pension plans for their employees where the city or town is solely responsible for all aspects of the administration and funding of plan benefits. In these instances the municipality is responsible for determining plan provisions, obtaining actuarial valuations, making required contributions, investing assets and paying benefits to retirees.

Twenty–four Rhode Island communities have created one or more pension plans, which they administer for their employees. The actuarial value of assets collectively held by these plans was nearly $1.4 billion and the collective unfunded actuarial accrued liability for future benefits (for only these locally administered pension plans) was nearly $1.9 billion (as of the most recent actuarial valuation referenced in their June 30, 2009 financial statements).

> *Various Locally Administered OPEB Plans*
>
> - *Administered by local governments*
> - Covers various categories of teachers, municipal employees - general, police and fire
> - Total plan assets – $18 million (as of most recent data available in FY 2009 audit reports)
> - Unfunded Actuarial Accrued Liability - $2.4 billion (as of most recent audit reports)
> - Collective funded ratio – 1% (as of the most recent information included in fiscal 2009 audit reports)

Many municipalities have established other post-employment benefit programs (OPEB) for their employees which generally consist of retiree health-care benefits. For these OPEB plans, the city or town is solely responsible for all aspects of the administration and funding of plan benefits. Additionally, the municipality is responsible for determining plan provisions, obtaining actuarial valuations, making required contributions, investing assets, and paying benefits to retirees. Although pension benefits for teachers are provided through the State administered ERSRI, retiree healthcare benefits are provided through the municipality. Teachers may opt to purchase retiree healthcare coverage through the State's OPEB plan but the State assumes no funding obligation for benefits.

Most Rhode Island communities have created one or more OPEB plans, which they administer for their employees. The actuarial value of assets collectively held by these plans was only $18 million and the collective unfunded actuarial accrued liability for future benefits (for only these locally administered OPEB plans) was nearly $2.4 billion (as of the most recent actuarial valuation referenced in their June 30, 2009 financial statements).

A schedule on page 8 shows the various plans that each Rhode Island municipality administers or participates in.

Rhode Island Municipalities' Defined Benefit Pension and OPEB Plans

	ERS	MERS			OTHER PLANS	LOCAL PENSION PLANS		OPEB
Municipality	Teachers	Municipal Employees	Police	Fire	Not Administered by Municipality	Administered by Municipality	Covered employees	PLANS
Barrington	●	●	●	●				●
Bristol	●	●	●	●		●	Police (prior to 3/22/98)	●
Burrillville	●	●	●					●
Central Falls	●	●				●	Police & Fire (prior to 7/1/72) and Police & Fire (after 7/1/72)	●
Charlestown	●	●	●					●
Coventry	●					●	Municipal Employees, Police, School Employees (other than teachers)	●
Cranston	●	●	●	●	●	●	Police & Fire EE's Pension Plan (prior to 7/1/95)	●
Cumberland	●	●		●		●	Police and other former employees	●
East Greenwich	●	●	●					●
East Providence	●	●				●	Fire & Police	●
Exeter	●	●						(a)
Foster	●	●	●					(a)
Glocester	●	●	●					●
Hopkinton	●	●	●					
Jamestown	●	●				●	Police	●
Johnston	●	●		●		●	Police, Fire (prior to 7/1//99)	●
Lincoln	●	●		●	●	●	Police, Fire, Town and School ee's	●
Little Compton	●					●	Town employees other than certified teachers	(a)
Middletown	●	●	●	●		●	All Town ee's hired prior to 7/1/01	●
Narragansett	●					●	Police (prior to 7/1/78) and Town Plan	●
New Shoreham	●	●	●					(a)
Newport	●	●				●	Fire and Police	●
North Kingstown	●	●	●	●				●
North Providence	●	●		●		●	Police Pension Plan	●
North Smithfield	●	●	●					●
Pawtucket	●	●				●	Pre 1974 Police & Fire (pay as you go) and Post 1974 Police and Fire	●
Portsmouth	●					●	Full-time Town employees except teachers	●
Providence	●				●	●	All city employees except teachers	●
Richmond	●	●	●					
Scituate	●	●				●	Police	●
Smithfield	●	●	●			●	Police (prior to 7/1/99), Fire	●
South Kingstown	●	●	●	●				●
Tiverton	●	●		●		●	Police	●
Warren	●	●	●	●				●
Warwick	●					●	City Employees, Police and Fire Pension I, Police and Fire Pension II, Public School Employees	●
West Greenwich	●	●	●					(a)
West Warwick	●					●	Full time town ee's (except teachers), Police and Fire	●
Westerly	●	●			●	●	Police	●
Woonsocket	●	●	●	●		●	Police (hired prior to 7/1/80), Fire (hired prior to 7/1/85)	●

(a) – Five municipalities will implement OPEB accounting requirements in their fiscal 2010 financial statements.

Accounting Principles Applicable To Governmental Pension and OPEB Plans

The Governmental Accounting Standards Board (GASB) issues accounting principles for governmental entities. In general, these accounting principles (1) require that periodic actuarial valuations be performed of governmental pension and OPEB plans, (2) define the acceptable actuarial methods that can be used in valuing pension benefit and OPEB liabilities, (3) define the annual amount that must be recognized as an expense (whether actually contributed or not) on a government's financial statements and (4) specify the pension and OPEB related disclosures that must be included in the annual financial reports of a governmental entity.

These accounting principles do not mandate how a government actually funds its pension and other post-employment benefit costs. A municipality that fails to contribute 100% of the annual required contribution to its pension or OPEB plan must disclose the actual amount contributed and report the full annual required contribution amount (funded and unfunded portion) as an expense in its government-wide financial statements. The amount reported in the fund level financial statements is only the actual amount funded. A municipality's government-wide financial statements should reflect, as a long-term liability, the cumulative difference between the annual required contribution amount and the amount actually contributed to its pension plan.

Governments are required to include basic information about their pension and OPEB plans that allows a reader of the financial statements to determine the unfunded actuarial accrued liability, the overall funded status of the plan and whether actual contributions are equal to 100% of annual required amounts.

MEASURING THE FISCAL HEALTH OF PENSION PLANS ADMINISTERED BY RHODE ISLAND MUNICIPALITIES

The primary objective of a defined benefit pension plan is to pay current and future benefits to its members. These benefit obligations cannot be met without the appropriate level of available assets. Many factors such as market volatility, changes in benefits, and changes in membership can affect the assets and liabilities or funding status of a plan. Proper planning and management is required to ensure that plan assets will be sufficient to support liabilities. Periodic actuarial valuations are a tool used by management to assess the development of the liability components of the plan and how they relate to plan assets.

Various measures can be used in assessing the fiscal health of a pension plan. We have selected the following measures because they are both appropriate and generally readily available from either periodic actuarial valuations or the annual audited financial statements of a governmental entity.

Annual required contribution (ARC)	The amount required to be contributed to the plan as determined by an actuary in accordance with the plan's actuarial funding methodology and assumptions. Any contribution amount less than 100% of the ARC warrants attention.
Net pension obligation (NPO)	When a government contributes 100% of the ARC, no liability is required to be presented on the face of the government's financial statements. When less than 100% of the ARC is contributed, the difference between the ARC and the actual contribution is reflected as a liability on the government's government-wide financial statements and is referred to as the net pension obligation. When an NPO exists on a government's financial statements, this amount represents the cumulative effect of contributions that should have been, but were not, made to a pension plan.
Unfunded actuarial accrued liability (UAAL)	The Actuarial Accrued Liability (AAL) is the present value of fully projected benefits attributable to service credit that has been earned. The Unfunded Actuarial Accrued Liability (UAAL) is the difference between the AAL and the actuarial value of assets available to pay benefits.
Funded ratio – overall funding status of the plan	The funded ratio of a pension plan is the relative value of the plan's assets and liabilities. The Plan's funded ratio is determined by dividing the actuarial value of assets by the actuarial value of liabilities.
Investment Performance	In addition to contributions, investment income is another source of funds to provide current and future pension benefits. Investment performance can be measured against the actuarial assumed rate of return and investment returns obtained by other similar investors.

Ultimately, the pertinent considerations regarding funding a public pension plan is the ability of the plan sponsor to continue to pay promised benefits and to make required contributions without causing fiscal stress; and whether the plan's unfunded liability is being amortized over an appropriate time period.

Locally-administered Pension Plans Considered at Risk

We identified 23 plans administered by 18 municipalities that we considered to be at risk.

Locally-administered Pension Plans Considered at Risk

Municipality	Pension Plan	Date of Valuation	Unfunded Actuarial Accrued Liability	Funded Ratio	Percentage of ARC made in Fiscal 2009
Category 1 - Plan is significantly underfunded (<60%) and annual contributions are significantly less than annual required amounts (<80%).					
Central Falls	Police & Fire (after 7/1/72) John Hancock	7/1/2008	$ 24,909,502	30.2%	0.0%
Coventry	School EE's Pension Plan	9/1/2008	18,340,664	36.9%	34.9%
East Providence [2]	Firemen's & Policemen's Pension Plan	10/31/2008	49,204,669	57.1%	25.1%
Johnston	Fire (prior to 7/1/99)	7/1/2009	47,625,201	26.8%	76.5%
Pawtucket	Post 1974 Policemen & Firemen	7/1/2008	108,531,436	38.8%	59.9%
Warwick	Police Pension I & Fire Pension Plan	7/1/2007	203,254,318	27.2%	64.6%
West Warwick	Town Plan	7/1/2008	68,233,034	39.5%	21.4%
Category 2 - Plan is significantly underfunded (<60%) and annual contributions are more than 80% of annual required amounts.					
Central Falls	Police & Fire (prior to 7/1/72) 1%	7/1/2008	$ 13,827,416	8.1%	100.4%
Coventry	Police Pension Plan	7/1/2008	36,620,259	17.4%	83.2%
Coventry	Town's Municipal EE Retirement Plan	7/1/2008	8,868,151	29.6%	89.1%
Cranston	Police & Fire EE's Pension Plan (prior to 7/1/95)	7/1/2009	244,237,000	15.1%	95.1%
Cumberland	Town of Cumberland's Pension Plan	7/1/2009	12,560,781	44.6%	100.0%
Johnston	Police	7/1/2009	37,209,735	27.6%	84.4%
Newport	Firemen's Pension Plan	7/1/2008	45,279,655	39.5%	105.5%
Providence	ERS of the City of Providence	6/30/2009	804,801,000	33.5%	99.8%
Scituate	Police Pension Plan	4/1/2009	7,481,437	23.4%	95.2%
Smithfield [9]	Police (prior to 7/1/99)	7/1/2009	16,368,403	17.9%	n/a
Tiverton	Policemen's Pension Plan	7/1/2009	8,509,687	40.3%	100.0%
Westerly	Police Pension Plan	7/1/2008	11,878,216	54.3%	87.9%
Category 3 - Plan is more than 60% funded but annual contributions are significantly less than required amounts (<80%) and generally declining over a multi-year period.					
Little Compton	Town Employees Other than Certified Teachers	7/1/2008	$ 1,602,576	78.5%	79.7%
Narragansett	Town Plan	7/1/2008	13,441,418	79.8%	54.5%
North Providence	Police Pension Plan	7/1/2007	9,370,009	68.5%	53.7%
Smithfield	Fire Pension Plan	7/1/2009	2,793,496	77.8%	53.7%

See Note 1 (page 41)

The plans in the preceding table are listed alphabetically by municipality within each risk category. Our assessment of plans includes information included in the municipality's fiscal 2009 audited financial statements and in certain instances actuarial valuations provided by the municipalities.

The 13 locally administered plans not considered at risk (those excluded from the preceding tables) still require continual commitment to fund the plan responsibly by contributing 100% of annual required amounts and move toward fully funding the plan. Options to merge the plan into the Municipal Employees' Retirement System to reduce administrative costs and enhance investment performance and diversification should still be pursued.

Annual Required Contribution

> ***Annual Required Contribution***
>
> The amount required to be contributed to the plan as determined by an actuary in accordance with the plan's actuarial funding methodology and assumptions. Any contribution amount less than 100% of the ARC warrants attention.

Consistently funding 100% of the annual required contribution (ARC) to a pension plan is one of the best indicators of an entity's commitment to making incremental progress in meeting its obligation to employees and retirees for pension benefits. If annual required contributions are consistently made, funding ratios will increase and the plan will eventually become fully funded. The table on page 14 demonstrates the actual percentage of the annual required contribution made by each locally administered pension plan over the five-year period 2005 - 2009.

The five-year ARC funding schedule on page 14 highlights that nine municipalities substantially underfund their respective annual required contribution for certain plans - Central Falls (1 of 2 plans), Coventry, East Providence, Narragansett, North Providence, Pawtucket, Smithfield, Warwick (1of 5 plans), and West Warwick. Three additional plans (Johnston Police, Johnston Fire, and Little Compton) are declining in the percentage of the annual contribution made in fiscal 2009 compared to prior years.

Continual underfunding pension obligations is viewed negatively by bond rating agencies and others assessing the fiscal health of a community. For example, a recent downgrade in the credit rating assigned to the Town of West Warwick cited the following:

> "The downgrade is based on the town's reduced financial position following consecutive operating deficits, continued pressures related to the fiscal challenges of the school department and a growing net pension obligation due to the long-term practice of not fully funding the town's annually required contribution (ARC) for pensions. The town's unfunded pension liability increased by $37 million or over 200% between 2001 and 2006, bringing the system's funded ratio down to a low 45% from 77% with additional declines expected given recent market losses. West Warwick's contribution as a percent of the ARC has ranged from 0% to 56% over the last six years, with only partial funding budgeted again in fiscal 2010." *(Moody's Investors Service – Town of West Warwick – August 5, 2009)*

The funded ratio of the West Warwick pension plan was reported at 39.5% in the June 30, 2009 audited financial statements of the town.

In contrast, Moody's Investors Service recognized Cranston's improvement in nearing 100% funding of its annual required contribution in its June 2008 rating:

> "Moody's believes that continued reduction of the unfunded pension liability in addition to management's ability to maintain structural balance and reserve levels, is key to the city's overall credit quality and will be an integral part of any future rating analysis." (*Moody's Investors Service - City of Cranston –June 16, 2008)*

Since property taxes are the primary revenue source for most Rhode Island municipalities, we prepared a schedule comparing each municipality's total actuarially determined annual required contribution, for all plans that it administers or participates in, to its total property tax levy for fiscal year 2009 (see page 31). In the aggregate, approximately 25% of the property tax levy would be required to fund 100% of the annual required contribution for both pension and OPEB plans. This means that $1 of every $4 raised through property taxes is needed to cover just pension and OPEB costs each year. For some communities, the percentage of their tax levy needed to fund their pension plans by contributing actuarially determined amounts is even more significant. In Central Falls, Pawtucket, and Johnston the annual required contributions (for pensions and OPEB) were 57%, 59%, and 47%, respectively, of their annual property tax levy.

The wide disparity in the percentage of the annual property tax levy that would be required to fund 100% of the annual required contribution to all pension and OPEB plans can be attributed to a variety of factors including differences in benefit provisions and the impact of continual underfunding in prior years. Generally, those communities that administer local plans have the higher percentage of total ARC to total property tax levy.

The very significant annual required contribution to pension and OPEB plans are largely a by-product of past underfunding of the plans. For example, the fiscal 2009 annual required contribution to the City of Providence's pension plan for its employees (excluding teachers) was $48.5 million of which the City made 100% of the required contribution. The composite employer contribution rate (different rates are actually applied to different groups of employees - e.g., police, fire, general) was 41.95% of payroll. Within the rate, only 5.81% related to normal or current service costs and 36.14% related to amortization of the unfunded liability and interest thereon. This underscores the very dramatic impact of past underfunding on current required contributions.

The higher cost of not making consistent and timely contributions is also evident in the example of the City of Cranston's Police and Fire Employees Retirement System. The annual required contribution for fiscal 2009 was $20.1 million. This plan covers 70 active members and 426 retirees for a total of 496 individuals. In contrast, the <u>aggregate</u> annual required contribution for <u>all</u> participating entities in the Municipal Employees Retirement System (MERS) was $33.5 million covering a total of 14,667 individuals (active and retirees). This significant disparity in the relative annual required contribution between the plans results in part from the impact of Cranston not contributing required amounts each year in the past.

One of the key advantages of participating in the State administered MERS plan is that 100% of the annual required contribution <u>must</u> be made. The general laws provide for deducting required contribution amounts due the State Employees' Retirement System from state aid payments to the municipality. This seeming lack of flexibility and forced discipline is actually a benefit due to the dramatically increased costs associated with deferring contributions to a pension plan.

Rhode Island Municipal Pension Plans - Percentage of Annual Required Contributions Made - Fiscal Years 2005-2009

(shaded) =actual contribution is <80% of ARC

Municipality	Pension Plan	2005 ARC	2005 %	2006 ARC	2006 %	2007 ARC	2007 %	2008 ARC	2008 %	2009 ARC	2009 %	Comments
Bristol	Police Pension Plan (prior to 3/22/98)	$ 329,562	77%	$ 438,015	53%	$ 540,519	117%	$ 620,203	127%	$ 640,220	100%	consistently funding at least 100% since 2007
Central Falls	Police & Fire John Hancock (after 7/1/72)	1,949,325	42%	1,949,325	8%	2,108,373	28%	2,108,373	58%	2,573,298	0%	substantial underfunding of ARC
	Police & Fire 1% (prior to 7/1/72)	974,873	126%	974,873	127%	1,276,317	99%	1,276,317	100%	1,265,866	100%	consistently funding at least 100% of ARC
Coventry	Town's Municipal EE Retirement Plan	1,363,517	14%	1,443,927	13%	1,567,266	60%	1,361,081	48%	806,558	89%	substantial underfunding of ARC - see Note 3
	Police Pension Plan	4,870,087	28%	5,479,790	28%	4,921,572	88%	4,071,928	61%	3,084,953	83%	substantial underfunding of ARC - see Note 3
	School EE's Pension Plan	-	n/a	-	n/a	1,077,105	63%	1,077,105	64%	1,974,659	35%	substantial underfunding of ARC - see Note 4
Cranston	Police & Fire EE's Pension Plan (prior to 7/1/95)	22,147,958	90%	21,723,021	98%	21,723,021	100%	20,785,343	96%	20,062,219	95%	mostly consistent funding of ARC
Cumberland	Town of Cumberland's Pension Plan	763,015	100%	806,797	101%	737,697	100%	923,078	100%	1,135,722	100%	consistently funding at least 100% of ARC
East Providence	Firemen's & Policemen's Pension Plan	3,931,287	20%	4,192,401	24%	4,595,332	33%	4,830,497	32%	6,256,502	25%	substantial underfunding of ARC - See Note 2
Jamestown	Police Pension Plan	98,313	282%	98,313	222%	122,028	142%	130,774	160%	139,929	123%	consistently funding at least 100% of ARC
Johnston	Police	2,545,000	100%	2,659,000	100%	2,743,000	99%	2,839,000	102%	3,338,000	84%	declining funding of ARC
	Fire (prior to 7/1/99)	3,187,000	84%	3,330,000	93%	3,100,000	114%	3,209,000	101%	3,704,000	76%	declining funding of ARC
Lincoln	Town Retirement Plan	136,746	158%	309,674	106%	348,818	100%	358,880	100%	386,977	100%	consistently funding at least 100% of ARC
Little Compton	Town Employees Other than Certified Teachers	281,263	113%	303,154	93%	358,331	85%	338,040	106%	424,375	80%	declining funding of ARC
Middletown	Town Plan	2,427,677	98%	2,617,280	98%	2,383,896	115%	2,475,038	100%	2,715,725	95%	mostly consistent funding of ARC
Narragansett	Police Plan (prior to 7/1/78)	77,509	65%	71,561	98%	80,656	0%	80,656	267%	77,093	0%	pay-as-you-go; paid $106,622 in benefits to 13 retirees in 2009
	Town Plan	2,255,815	43%	2,184,453	47%	2,653,919	40%	3,379,131	34%	2,462,870	55%	substantial underfunding of ARC
Newport	Firemen's Pension Plan	4,118,543	124%	3,543,234	100%	3,352,662	106%	3,291,226	100%	3,310,657	105%	consistently funding at least 100% of - see Note 7
	Policemen's Pension Plan	3,389,486	115%	2,440,649	100%	2,385,996	102%	2,272,177	100%	2,406,091	103%	consistently funding at least 100% of ARC - see Note 7
North Providence	Police Pension Plan	1,140,847	95%	1,255,035	92%	1,255,035	77%	1,525,120	55%	1,529,633	54%	declining funding of ARC
Pawtucket	Pre 1974 Policemen & Firemen (pay-as-you-go)	984,035	79%	925,047	81%	930,140	77%	859,343	80%	790,725	82%	funded on a pay-as-you-go basis - see Note 8
	Post 1974 Policemen & Firemen	6,068,846	52%	6,699,593	52%	7,362,251	52%	7,433,922	57%	8,117,103	60%	substantial underfunding of ARC - see Note 8
Portsmouth	Employees of the Town of Portsmouth	1,370,682	100%	1,552,169	100%	1,671,713	100%	2,088,317	100%	2,346,316	100%	consistently funding at least 100% of ARC
Providence	ERS of the City of Providence	49,329,000	92%	51,454,000	96%	50,584,000	100%	54,120,000	100%	48,509,000	100%	mostly consistent funding of ARC
Scituate	Police Pension Plan	414,630	99%	410,834	101%	410,834	101%	472,897	94%	472,897	95%	mostly consistent funding of ARC
Smithfield	Police (prior to 7/1/99)	1,379,908	98%	1,252,918	126%	-	n/a	-	n/a	-	n/a	pay-as-you go for 40 retirees - see Note 9
	Fire Pension Plan	627,734	61%	707,557	68%	912,526	53%	693,229	81%	1,044,019	54%	substantial underfunding of ARC
Tiverton	Policemen's Pension Plan	631,676	78%	648,059	100%	647,343	92%	597,226	100%	711,225	100%	mostly consistent funding of ARC
Warwick	City Employees Pension Plan	2,401,183	100%	3,043,476	100%	3,165,215	100%	3,211,753	100%	3,340,223	100%	consistently funding at least 100% of ARC
	Police Pension II Plan	1,729,765	100%	1,917,484	100%	2,359,189	100%	2,285,974	100%	2,369,750	100%	consistently funding at least 100% of ARC
	Police Pension I & Fire Pension Plan	10,112,932	100%	10,517,450	100%	19,719,971	62%	19,816,479	64%	19,551,645	65%	substantial underfunding of ARC in past three years
	Fire Pension Plan II	866,234	100%	1,081,926	100%	1,334,416	100%	1,432,908	100%	1,535,840	100%	consistently funding at least 100% of ARC
	Warwick Public Schools Employee Pension Plan	1,557,272	96%	1,503,550	84%	1,700,598	71%	1,439,385	106%	1,569,248	100%	consistently funding at least 100% of ARC since 2008
West Warwick	Town Plan	2,617,422	0%	3,100,394	47%	3,553,780	56%	4,082,436	56%	4,676,096	21%	substantial underfunding of ARC
Westerly	Police Pension Plan	1,301,600	96%	1,355,800	96%	1,502,900	86%	825,961	79%	1,249,700	88%	underfunding of ARC -see Note 6
Woonsocket	Police (pre 7/1/80) & Firemen's (pre 7/1/85) Plan	-	n/a	-	n/a	-	n/a	32,100	100%	1,518,900	2%	Note 5
	Totals:	$ 137,380,742	85%	$ 141,990,759	87%	$ 153,186,419	87%	$ 156,344,897	86%	$ 156,098,034	82%	

Net Pension Obligation

> ***Net Pension Obligation***
>
> When a government contributes 100% of the ARC, no liability is required to be presented on the face of the government's financial statements. When less than 100% of the ARC is contributed, the difference between the ARC and the actual contribution is reflected as a liability on the government's government-wide financial statements and is referred to as the net pension obligation. When an NPO exists on a government's financial statements, this amount represents the cumulative effect of contributions that should have been, but were not, made to a pension plan.

The net pension obligation (NPO) is an amount defined by generally accepted accounting principles (GAAP) for governments. This liability is included in an entity's government-wide (accrual accounting basis) financial statements along with other long-term liabilities such as bonds payable. It represents the cumulative difference between amounts actually contributed to a pension plan and the annual required contribution as determined by an actuary in accordance with guidelines permitted by GAAP.

The NPO is a measure of the effect of not contributing the annual required contribution amount. The NPO amount, together with cumulative investment income, would have been available within the plan to fund future liabilities if the annual required contribution had been made. Nearly one-half of the City of Cranston's general long-term debt stems from the chronic failure to contribute actuarially determined amounts to fund the City's Police and Fire Employees Retirement System.

Locally administered pension plans with the largest net pension obligations are summarized below.

Locally Administered Pension Plan	Net Pension Obligation
Providence	$ 127,487,000
Cranston Police and Fire (pre 7/1/95)	88,325,767
Pawtucket Police and Fire (post 1974) [(8)]	75,076,824
East Providence Fire and Police (a)	35,420,660
West Warwick	25,540,416
Central Falls Police and Fire (post 7/1/72)	24,211,526
Coventry Police	22,044,985
Warwick Police I and Fire	21,289,445
Narragansett Town Plan	11,590,589
Coventry Municipal Employee	8,094,171
Newport Fire	5,050,684
North Providence Police	4,221,783
Johnston Fire (pre 7/1/99)	3,503,000
Westerly Police	2,746,841
Scituate Police	2,189,275

(a) East Providence has an October 31 fiscal year end – NPO is as of 10-31-2009 and is unaudited.

Unfunded Actuarial Accrued Liability

> ***Unfunded Actuarial Accrued Liability***
>
> The Actuarial Accrued Liability (AAL) is the present value of fully projected benefits attributable to service credit that has been earned. The Unfunded Actuarial Accrued Liability (UAAL) is the difference between the AAL and the actuarial value of assets available to pay benefits.

The Unfunded Actuarial Accrued Liability (UAAL) is determined as a result of periodic actuarial valuations usually performed annually. The UAAL is the by-product of measuring both the assets and projected benefits (liabilities) of the plan using actuarial assumptions and methodologies. These measures become the basis for developing the annual required contribution amount and the funded ratio.

Basically, the UAAL demonstrates how well assets have been accumulated to meet future benefit obligations to retirees. The UAAL is expressed in dollars whereas the funded ratio uses the same data to express what percentage of the liability for future benefits (AAL) has been funded by the actuarial value of assets.

Some governments have issued pension obligation bonds to finance the unfunded actuarial accrued liability in their pension funds. In essence the pension obligation bonds provide a source of cash to pay off the unfunded pension liability. In selling these bonds, governments are counting on plan investment earnings being greater than the interest paid on the pension obligation bonds. Obviously, there is the risk that the market may not generate investment returns to exceed the rate paid on the bonds. Furthermore, once the bonds are issued, a government is committed to the debt service schedule whereas a government typically has more flexibility in deciding on the amount and the specific timing of future pension contributions. Through issuance of pension obligation bonds, a “soft” liability is exchanged for a “hard” liability.

The consideration of pension obligation bonds is often controversial since the amount of bonds contemplated is usually significant to the entity’s overall debt burden and the market returns required to ensure the viability of the proposal are anything but certain. The worst-case scenario occurs when investment returns fail to meet required amounts and further contributions are required to the pension plan in addition to the debt service on the bonds. Locally, the City of Woonsocket issued $90 million of pension obligation bonds in fiscal 2003. In fiscal 2009, due in part to investment losses, the City recognized an annual required contribution of $1.5 million in addition to the debt service on its pension obligation bonds.

The table on the next page highlights the unfunded actuarial accrued liability and funded ratio (as of the most recent valuation included in the municipality’s fiscal 2009 financial statements) for each of the 36 pension plans administered by Rhode Island municipalities including the funded ratio trend for the period 2005-2009.

Rhode Island Municipal Pension Plans - Unfunded Actuarial Accrued Liability (UAAL)

Municipality	Pension Plan	Date of Valuation	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Funded Ratio Trend
Bristol	Police Pension Plan (prior to 3/22/98)	7/1/2008	$ 13,130,907	$ 20,456,564	$ 7,325,657	64.2%	decreasing
Central Falls	Police & Fire (after 7/1/72) John Hancock	7/1/2008	10,791,609	35,701,111	24,909,502	30.2%	decreasing
	Police & Fire (prior to 7/1/72) 1%	7/1/2008	1,210,773	15,038,189	13,827,416	8.1%	increasing
Coventry	Town's Municipal EE Retirement Plan	7/1/2008	3,720,455	12,588,606	8,868,151	29.6%	decreasing through 2006 then increasing in 2007 & 2008
	Police Pension Plan	7/1/2008	7,691,937	44,312,196	36,620,259	17.4%	consistent between 6 to 8% then increase 2007 & 2008
	School EE's Pension Plan (4)	9/1/2008	10,721,962	29,062,626	18,340,664	36.9%	decreasing
Cranston	Police & Fire EE's Pension Plan (prior to 7/1/95)	7/1/2009	43,418,000	287,655,000	244,237,000	15.1%	increasing through 2007 then decreasing in 2008 & 2009
Cumberland	Town of Cumberland's Pension Plan	7/1/2009	10,122,643	22,683,424	12,560,781	44.6%	decreasing
East Providence	Firemen's & Policemen's Pension Plan (2)	10/31/2008	65,468,953	114,673,622	49,204,669	57.1%	decreasing
Jamestown	Police Pension Plan	7/1/2009	7,162,384	7,137,088	(25,296)	100.4%	increasing >100% except decrease to 100% in 2009
Johnston	Police	7/1/2009	14,201,866	51,411,601	37,209,735	27.6%	inconsistent, but decreased from 2007 to 2009
	Fire (prior to 7/1/99)	7/1/2009	17,472,877	65,098,078	47,625,201	26.8%	inconsistent, but decreased from 2007 to 2009
Lincoln	Town Retirement Plan	1/1/2008	17,152,451	19,139,010	1,986,559	89.6%	decreasing
Little Compton	Town Employees Other than Certified Teachers	7/1/2008	5,849,516	7,452,092	1,602,576	78.5%	from 2003 - 2007 increasing but decreased in 2008
Middletown	Town Plan	7/1/2008	43,215,258	51,273,315	8,058,057	84.3%	consistent
Narragansett	Police Plan (prior to 7/1/78)	7/1/2008	3,525	914,018	910,493	0.4%	decreasing then increasing 2008
	Town Plan	7/1/2008	53,153,249	66,594,667	13,441,418	79.8%	consistent
Newport	Firemen's Pension Plan	7/1/2008	29,605,715	74,885,370	45,279,655	39.5%	increasing through 2007 then decreasing in 2008
	Policemen's Pension Plan	7/1/2008	41,952,553	68,177,847	26,225,294	61.5%	increasing through 2007 then decreasing in 2008
North Providence	Police Pension Plan	7/1/2007	20,331,967	29,701,976	9,370,009	68.5%	decreasing then increasing in 2007

Rhode Island Municipal Pension Plans - Unfunded Actuarial Accrued Liability (UAAL)

Municipality	Pension Plan	Date of Valuation	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Funded Ratio Trend
Pawtucket	Pre 1974 Policemen & Firemen (pay as you go) (8)	7/1/2008	-	4,100,000	4,100,000	0.0%	pay as you go plan - 71 retirees
	Post 1974 Policemen & Firemen (8)	7/1/2008	68,844,727	177,376,163	108,531,436	38.8%	decreasing
Portsmouth	Employees of the Town of Portsmouth	7/1/2009	31,609,237	51,284,315	19,675,078	61.6%	decreasing
Providence	ERS of the City of Providence	6/30/2009	405,217,000	1,210,018,000	804,801,000	33.5%	decreasing
Scituate	Police Pension Plan	4/1/2009	2,286,905	9,768,342	7,481,437	23.4%	increasing then significant decrease in 2009
Smithfield	Police (prior to 7/1/99) (9)	7/1/2009	3,574,925	19,943,328	16,368,403	17.9%	decreasing
	Fire Pension Plan	7/1/2009	9,793,908	12,587,404	2,793,496	77.8%	decreasing
Tiverton	Policemen's Pension Plan	7/1/2009	5,732,961	14,242,648	8,509,687	40.3%	decreasing
Warwick	City Employees Pension Plan	7/1/2008	81,654,940	103,090,691	21,435,751	79.2%	consistent
	Police Pension II Plan	7/1/2007	125,715,755	119,787,659	(5,928,096)	104.9%	decreasing then increased 7/1/07
	Police Pension I & Fire Pension Plan	7/1/2007	75,998,043	279,252,361	203,254,318	27.2%	consistent
	Fire Pension Plan II	7/1/2007	12,695,030	13,093,095	398,065	97.0%	decreasing then increased 7/1/07
	Warwick Public Schools Employee Pension Plan	7/1/2008	33,594,082	39,704,426	6,110,344	84.6%	consistent
West Warwick	Town Plan	7/1/2008	44,536,601	112,769,635	68,233,034	39.5%	decreasing
Westerly	Police Pension Plan	7/1/2008	14,135,584	26,013,800	11,878,216	54.3%	decreasing
Woonsocket	Police (pre 7/1/80) and Fire (pre 7/1/85) Pension Plan (5)	7/1/2008	87,968,606	97,355,537	9,386,931	90.4%	decreasing
		Totals	$ 1,419,736,904	$ 3,314,343,804	1,894,606,900	42.8%	
MERS (state- administered aggregate)		6/30/2008	1,174,567,205	1,266,286,829	91,719,624	92.8%	decreasing then increasing in 2007 & 2008
Employees' Retirement System of RI - State employees		6/30/2008	2,700,368,568	4,371,829,709	1,671,461,141	61.8%	decreasing then increasing in 2007 & 2008
Employees' Retirement System of RI - Teachers (state-administered)		6/30/2008	4,044,954,378	6,705,498,005	2,660,543,627	60.3%	decreasing then increasing in 2007 & 2008

The cost of providing pension payments to plan members can vary widely among plans and is affected by numerous factors. Calculating the UAAL per plan member allows comparison of plans of different sizes as illustrated in the table below.

Pension Plan	UAAL	Plan members (a)	UAAL per plan member
Locally administered pension plans (aggregate) (b)	$ 1,894,606,900	13,974	$ 135,581
MERS (state administered - aggregate) (b)	$ 91,719,624	14,667	$ 6,253
Providence – ERS of the City of Providence	$ 804,801,000	5,853	$ 137,502
Cranston – Police and Fire (pre 7/1/95)	$ 244,237,000	496	$ 492,413
Warwick – Police Pension I and Fire Pension Plan	$ 203,254,318	470	$ 432,456
Employees' Retirement System of RI – State employees	$ 1,671,461,141	24,893	$ 67,146
Employees' Retirement System of RI – Teachers (state administered)	$ 2,660,543,627	25,746	$ 103,338

General – plan benefits and member characteristics (e.g., average salary) can vary significantly between plans which affects the comparability of the UAAL per plan member. UAAL is as of the most recent valuation included in the entity's fiscal 2009 audited financial statements unless otherwise noted.

(a) plan members include active employees, terminated employees not collecting benefits, retirees, and beneficiaries.

(b) separate actuarial valuations are performed for each unit; the UAAL presented is the aggregate UAAL for all units -- no adjustment has been made for the inclusion of individual plans which are overfunded in the aggregate UAAL for all plans – inclusion of overfunded plans in the aggregate UAAL understates the UAAL per member.

Since plan benefits and plan member characteristics can vary significantly among plans, one must exercise caution in drawing specific conclusions from the UAAL per plan member. It is clear, however, that the UAAL is significantly impacted by failure to contribute required amounts, investment performance and specific benefit provisions. It is noteworthy that MERS has the highest funded ratio (92.8%) of the plans used in the foregoing comparison and it also has the smallest UAAL per plan member. For four of the last six years for which funding progress data is presented (see Appendix A) the MERS funded ratio was greater than 90%. This demonstrates that timely and consistent funding of annual required amounts will generally result in significantly reduced pension costs.

Funded Ratio

Funded Ratio

The funded ratio of a pension or OPEB plan is the relative value of the plan's assets and liabilities. The Plan's funded ratio is determined by dividing the actuarial value of assets by the actuarial value of liabilities.

The funded ratio quantifies the overall funding status of the plan and is a key measure of the fiscal health of a pension plan. It represents the relative value of the plan's assets compared to plan liabilities. The Plan's funded ratio is determined by dividing the actuarial value of assets by the actuarial value of liabilities.

Conceptually, a pension fund should be at or near 100% funded meaning that sufficient assets have been accumulated to meet estimated future pension liabilities. The further a plan is from 100% funded, the greater the risk that, without increased contributions and investment income or gains, assets will be insufficient to meet expected pension benefits. Larger contributions are required to make-up for the funding deficiency when plans are significantly less than the 100% funded ratio.

At the other end of the spectrum from plans that are 100% funded, plans that are pay-as-you-go use current receipts to pay current benefits with no assets set aside for future costs. In most cases, pay as you go plans eventually become too expensive to support with only tax receipts and contributions. This typically occurs in an established plan where the number of retirees continually increases yet the number of active employees decreases or remains relatively constant. Investment earnings count for most of the revenue generated by a prefunded plan, lessening the impact on employer contributions.

Overall, states' retirement systems were 84 percent funded [1] which is over the 80% funding ratio that most experts deem a target that must be reached before a plan can be considered reasonably funded. Given that measure, aside from the State administered MERS plan with a funded ratio of 93%, the State employee and teacher plans with funded ratios of 62% and 60%, respectively, are not well funded. The funded ratios for these plans have increased from our prior report due in part to benefit restructuring.

We identified local plans considered to be at risk based on the criteria described on page 11. Recent initiatives in other states to identify pension plans at risk have generally targeted any plan with a funded ratio less than 80%. Using this parameter, there are a number of municipalities in Rhode Island with locally-administered pension plans that are at risk (based on the most recent funded ratio reported in each municipality's fiscal 2009 audited financial statements).

Twenty-seven self-administered pension plans have funded ratios of less than 80%. The table on the next page list these 27 plans based on the 2009 audit reports of the respective municipality. The actual percentage of their annual required contribution made in fiscal 2009 is also included in the table.

- Seventeen of the 27 self-administered pension plans have funded ratios of less than 50%; four are less than 20% funded.

- For nineteen plans with a funded ratio less than 80%, the funded ratio had decreased compared to the funded ratio included in our previous report.

The same statistics are also presented for the state administered pension plans for comparison purposes.

[1] The Pew Center on the States – February 2010 – The trillion dollar gap – Underfunded state retirement systems and the roads to reform

Locally Administered Pension Plan (see note 1 page 41)	Current Funded Ratio (A)	Prior Funded Ratio (B)	% of ARC Contributed in Fiscal 2009
Central Falls Police and Fire (prior to 7/1/72)	8.1%	7.3%	100%
Cranston Police and Fire (pre 7/1/95)	15.1%	15.5%	95%
Coventry Police	17.4%	8.0%	83%
Smithfield Police (prior to 7/1/99) (note 9)	17.9%	36.0%	n/a
Scituate Police	23.4%	37.0%	95%
Johnston Fire (prior to 7/1/99)	26.8%	30.7%	76%
Warwick Police Pension I and Fire	27.2%	27.0%	65%
Johnston Police	27.6%	30.8%	84%
Coventry Municipal Employees	29.6%	18.0%	89%
Central Falls Police and Fire (after 7/1/72)	30.2%	34.6%	0%
Providence	33.5%	37.4%	100%
Coventry School Employees (note 4)	36.9%	46.6%	35%
Pawtucket Post 1974 Police and Fire (note 8)	38.8%	42.5%	60%
West Warwick Town Plan	39.5%	48.0%	21%
Newport Firemen's (note 7)	39.5%	40.0%	105%
Tiverton Police	40.3%	49.9%	100%
Cumberland	44.6%	59.5%	100%
Westerly Police	54.3%	43.4%	88%
East Providence Firemen's & Policemen's (note 2)	57.1%	70.0%	25%
Newport Policemen's (note 7)	61.5%	62.5%	103%
Portsmouth	61.6%	65.3%	100%
Bristol Police (prior to 3/22/98)	64.2%	67.0%	100%
North Providence Police	68.5%	67.5%	54%
Smithfield Fire	77.8%	86.0%	54%
Little Compton	78.5%	80.5%	80%
Warwick City Employees	79.2%	78.5%	100%
Narragansett Town	79.8%	79.0%	55%

Funded ratio A = as reported in most recent audited financial statements (generally June 2009), and B = as reported in our July 2007 report, highlighted cells indicate a decline in the funded ratio compared to July 2007

State Administered Pension Plans	Funded Ratio June 30, 2008 [a]	Funded Ratio June 30, 2005 [a]	% of ARC Contributed
Employees' Retirement System - State Employees	61.8%	56.3%	100%
Employees' Retirement System - Teachers	60.3%	55.4%	100%
Municipal Employees' Retirement System	92.8%	87.2%	100%

[a] Actuarial valuation date

Investment Performance

> ***Investment Performance***
>
> In addition to contributions, investment income is another source of funds to provide current and future pension benefits. Investment performance can be measured against the actuarial assumed rate of return and investment returns obtained by other similar investors.

After making annual required contributions, the next most important factor impacting the financial health of a pension plan is overall investment performance. Achieving average investment returns equal to the assumed rate of return is necessary to meet planned funding targets. Failure to meet the assumed rate of return adds to the growth in plan liabilities.

The assumed rates of return for pension plans administered by Rhode Island municipalities ranged from 7.0% to 8.5%. The assumed rate of return used by the State of Rhode Island Employees Retirement System is 8.25%.

According to *Public Fund Survey Summary of Findings for FY 2008* issued by the National Association of State Retirement Administrators in October 2009, over time, investment earnings account for the majority of public pension fund revenues. The prominence of investment earnings in the financing arrangement magnifies the role of a pension fund's investment return on its funding condition.

Smaller plans typically have difficulty achieving the overall investment performance of larger plans because they have fewer opportunities to spread risk, cannot invest as efficiently (higher costs), may not have access to all types of potentially higher yielding investments and may not have developed appropriate asset allocation strategies to diversify risk.

The average five-year investment performance of the locally-administered pension plans in Rhode Island was in most instances less than the returns earned by the State administered Employee's Retirement System of RI (ERSRI). The collective average return was 1.94% compared to 3.2% earned by the ERSRI. Some municipalities were excluded from our average calculation due to inconsistent measurement periods (see end notes).

The five-year average rate of return and comparison to the assumed rate of return for the Employees' Retirement System is highlighted below. The same comparison for each of the locally administered pension plans is included in the table on the next page.

		Actual Rate of Return						
Pension Plan	Assumed Rate of Return	2005	2006	2007	2008	2009	Average rate of return (a)	Average return compared to assumed return
Employees Retirement System- State of Rhode Island	8.25%	11.4%	11.6%	18.2%	-5.8%	-19.2%	3.2%	-5.01%

(a) The five-year time weighted return reported by the Employees' Retirement System for the period ended June 30, 2009 was 2.28%

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Rhode Island Municipal Pension Plans - Comparison of Assumed to Actual Rate of Return

Municipality	Pension Plan	Assumed Rate of Return	Actual Rate of Return					Average rate of return	Average return compared to assumed return
			2005	2006	2007	2008	2009		
Bristol	Police Pension Plan (prior to 3/22/98)	8.00%	5.34%	5.27%	13.35%	1.07%	-15.23%	1.96%	-6.04%
Central Falls	Police & Fire John Hancock (after 7/1/72) (10)	7.75%	10.74%	8.50%	2.72%	3.02%	2.67%	5.53%	-2.22%
	Police & Fire 1% (prior to 7/1/72)) (10)	7.50%	1.38%	2.10%	2.52%	2.08%	1.46%	1.91%	-5.59%
Cranston	Police & Fire EE's Pension Plan (prior to 7/1/95)	8.00%	2.90%	7.60%	17.00%	-5.20%	-15.00%	1.46%	-6.54%
Jamestown	Police Pension Plan (10)	7.00%	0.61%	3.30%	10.62%	-2.35%	-8.32%	0.77%	-6.23%
Johnston	Police	7.75%	4.42%	7.94%	10.01%	-1.79%	-15.44%	1.03%	-6.72%
	Fire (prior to 7/1/99)	7.75%	7.49%	8.50%	14.35%	-5.39%	-18.41%	1.31%	-6.44%
Little Compton	Town Employees Other than Certified Teachers	7.50%	7.50%	8.60%	16.60%	-6.20%	-18.00%	1.70%	-5.80%
Middletown	Town Plan	7.50%	6.92%	9.00%	13.80%	-3.91%	-13.30%	2.50%	-5.00%
Newport	Firemen's Pension Plan	8.25%	1.87%	7.34%	16.45%	-4.90%	-20.40%	0.07%	-8.18%
	Policemen's Pension Plan	8.25%	1.87%	7.34%	16.45%	-4.90%	-20.40%	0.07%	-8.18%
Pawtucket	Pre 1974 Policemen & Firemen (pay as you go)		n/a	n/a	n/a	n/a	n/a		
	Post 1974 Policemen & Firemen	8.00%	10.03%	6.98%	15.21%	1.41%	-14.32%	3.86%	-4.14%
Portsmouth	Employees of the Town of Portsmouth	8.00%	8.70%	4.58%	16.71%	-9.64%	-16.56%	0.76%	-7.24%
Providence	ERS of the City of Providence (11)	8.50%	8.30%	10.60%	16.26%	2.85%	-16.02%	4.40%	-4.10%
Smithfield	Police (prior to 7/1/99) (10)	8.50%	4.32%	7.30%	14.49%	-6.57%	-10.65%	1.78%	-6.72%
	Fire Pension Plan	8.50%	7.68%	8.20%	16.50%	-12.30%	-24.30%	-0.84%	-9.34%
Warwick	City Employees Pension Plan	8.00%	9.20%	9.10%	16.70%	-4.40%	-15.80%	2.96%	-5.04%
	Police Pension II Plan	8.00%	9.50%	9.40%	16.50%	-4.70%	-15.80%	2.98%	-5.02%
	Police Pension I & Fire Pension Plan	8.00%	9.20%	8.90%	15.70%	-3.90%	-16.00%	2.78%	-5.22%
	Fire Pension Plan II	8.00%	8.20%	9.00%	15.70%	-3.80%	-15.70%	2.68%	-5.32%
	Warwick Public Schools Employee Pension Plan	7.00%	6.73%	8.94%	14.61%	-2.78%	-15.94%	2.31%	-4.69%
West Warwick	Town Plan	8.25%	4.45%	8.65%	16.62%	-2.90%	-15.70%	2.22%	-6.03%
Westerly	Police Pension Plan	8.00%	4.80%	4.20%	12.30%	-6.50%	-7.20%	1.52%	-6.48%
Woonsocket	Police (pre 7/1/80) and Fire (pre 7/1/85) Plan	8.25%	8.50%	7.35%	15.02%	-9.29%	-17.24%	0.87%	-7.38%
Average		7.93%	6.28%	7.45%	14.01%	-3.79%	-14.23%	1.94%	-5.99%

Actual Rates of Return provided were not on a consistent basis for the following:

Coventry	Town's Municipal EE Retirement Plan (11 & 16)	8.00%	5.91%	7.15%	9.82%	-1.99%	-19.71%	0.24%	-7.76%
	Police Pension Plan (11 & 16)	8.00%	6.71%	7.35%	9.97%	-1.68%	-20.57%	0.36%	-7.64%
	School EE's Pension Plan (17)	7.00%	8.66%	unavailable	8.90%	-10.28%	-20.37%	-3.27%	-10.27%
Cumberland	Town of Cumberland's Pension Plan (12)	8.00%	-10.70%	3.95%	10.71%	-3.60%	17.00%	3.47%	-4.53%
East Providence	Firemen's & Policemen's Pension Plan (13)	8.50%	9.90%	17.50%	17.30%	-30.90%	15.60%	5.88%	-2.62%
Lincoln	Town Retirement Plan (14)	8.00%	7.90%	12.60%	3.60%	-26.50%	16.35%	2.79%	-5.21%
Narragansett	Police Plan (prior to 7/1/78) (pay as you go)	7.50%	6.25%	n/a	n/a	n/a	n/a		
	Town Plan (14)	7.50%	6.07%	10.66%	9.77%	-21.14%	20.13%	5.10%	-2.40%
North Providence	Police Pension Plan (15)	7.25%	8.20%	1.92%	24.41%	-19.24%	-12.94%	0.47%	-6.78%
Scituate	Police Pension Plan (13)	8.25%	6.94%	14.57%	10.91%	-2.69%	-25.45%	0.86%	-7.39%
Tiverton	Policemen's Pension Plan (12)	7.00%	5.18%	11.74%	9.31%	-28.71%	22.02%	3.91%	-3.09%

Of the 36 pension plans that are locally administered (as reported in the table on the preceding page) all experienced average five-year investment returns which were less than the assumed rate of return used in performing the annual actuarial valuation of the plans. The State Employees' Retirement System's actual five-year investment performance also trailed its assumed rate of return (8.25%) by approximately 5% (500 basis points). According to *No Immediate Pension Hardships for State and Local Governments, But Plenty of Long-Term Worries* issued by Standard & Poor's in June 2009, recent market pullbacks may cause actuaries in the next year or two to recommend reducing the long-term assumed actuarial rate of return.

It is important to note that the average investment performance for a specific five-year period can vary widely depending upon overall market performance in those years. Significant market downturns in both 2008 and 2009 had a significant impact on returns reported for those periods.

Investment return information is not typically disclosed in the annual audited financial statements of a municipality. We requested such information from the municipality or obtained data from their actuarial valuations. In some instances, we made our own approximation of investment returns based on financial data included in the municipality's audited financial statements. Our investment return calculations do not consider the timing of inflows and outflows within the pension fund which is typically included in such calculations. Investment return data reported to us by a municipality was not independently verified. Additionally, the annual investment return may not be computed on a consistent basis among plans. The average rate of return is an approximation only intended to demonstrate investment performance relative to a plan's rate of return assumption and between plans. We did not assess the investments held by each of the locally administered pension plans.

The actual rates of return for Rhode Island's locally administered pension plans supports the conclusion that smaller plans struggle to achieve the same rates of return earned by larger, well diversified and professionally managed plans. Further, larger plans are better able to manage investment risk through diversification.

Considering that investment performance can have a significant impact on the plan's funded status and contribution rates, efforts to improve investment performance by (1) merging the locally administered plans into the State administered Municipal Employees' Retirement System or (2) creating a state administered pooled investment trust for locally administered pension plans deserve serious consideration.

STATUS OF OTHER POST-EMPLOYMENT BENEFIT (OPEB) PROGRAMS

At the time of our previous report (July 2007), new accounting guidelines [2] relating to other post-employment benefits were on the horizon but were not yet effective for Rhode Island's municipalities. The effective date for these accounting requirements is in three phases depending on the size of the government. The largest municipalities were required to implement the new guidelines in their fiscal 2008 financial statements with the remainder in fiscal years 2009 and 2010.

These guidelines require governmental employers to measure the cost of the post-employment benefits provided to retirees (generally health-care) on an actuarial basis and recognize these costs (i.e., annual required contribution) in the entity's government-wide financial statements. The accounting measurement criteria for other post-employment benefit costs is similar to pensions and uses consistent terminology as well.

As a result of the implementation of this governmental accounting standard, municipalities have begun to disclose the future costs associated with providing post-employment benefits to its employees in their annual financial statements. For most communities, the future costs are very significant and largely unfunded. In most cases, governmental employers fund these costs on a pay-as-you-go basis and there has been little or no accumulation of assets to pay future benefits. Further, health care costs continue to increase at a dramatic pace; therefore, any projection of the future cost of benefits to retirees must reflect an aggressive cost escalation trend rate. These costs will further challenge Rhode Island municipalities as many are already struggling to properly fund their obligation for pension benefits.

The collective unfunded liability for OPEB benefits (UAAL) as shown in the table beginning on page 27 is $2.4 billion. Assets totaling less than 1% of the actuarial accrued liability have been set aside for the payment of future benefits. Information was unavailable for two communities: East Providence's fiscal year-end is October 31 and their audit has not been completed; and Woonsocket has not had an actuarial valuation performed of its OPEB benefit plan. On average, communities are funding 53% of the annual required contribution for OPEB benefits. The collective ARC for OPEB plans alone is $190 million.

The State implemented the same accounting standard in its fiscal 2008 financial statements and has not begun to fund the future costs of providing post-employment healthcare to its employees. The status of the State's OPEB plan is summarized below.

State's OPEB Plans Valuation date June 30, 2007	Actuarial Value of Assets	AAL	UAAL	Funded Ratio
State Employees	$ 0	$ 679,538,000	$679,538,000	0%
Teachers *	0	10,243,000	10,243,000	0%
Judges	0	14,024,000	14,024,000	0%
State Police	0	54,620,000	54,620,000	0%
Legislators	0	29,674.000	29,674.000	0%
* local teachers may "buy-in" to the State's plan at retirement – the State's obligation is a Tier I subsidy which in essence affords the teachers the active employee rate rather than a retiree rate for teachers who retired prior to October 1, 2008.				

[2] GASB Statement No. 45 *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions* requires governmental employers to obtain periodic actuarial valuations of their OPEB plans, report the annual required contribution as an expense on its government-wide financial statements, and disclose the funded status of the OPEB plan in a manner that is similar to accounting requirements for pensions by employers.

We did not compare, in detail, the benefits offered by the various locally administered OPEB plans. However, in general, the municipal plans appeared to be more generous than the State's OPEB plan for its employees. For example, under the municipal OPEB plans, full spousal and dependent coverage is common and a retiree co-pay is generally not required. The State's OPEB plan covers only employees (spousal and dependent coverage is available on a buy-in basis at full cost) and a 20% retiree co-pay is required for all employees retiring after October 1, 2008. Co-pay percentages for earlier retirees were determined based on years of service.

Calculation of the unfunded liability for OPEB plans is affected by whether assets have been placed in a legal trust. When no trust has been created (as is the case for many local plans as well as the State's OPEB plan), the investment return assumption used in discounting the future value of benefits to plan members should reflect the plan sponsor's investment return on its short-term operating accounts rather than an investment return assumption typically used for the pension asset investments. In these instances (no trust and consequently a lower investment return assumption or discount rate), the unfunded liability is significantly higher. Consequently, there is a significant financial benefit which accrues to a government when it creates a legal trust for assets funding OPEB liabilities. Aside from the obvious benefit of accumulating assets for future benefits, actuaries can use a higher investment return assumption consistent with a longer-term investment horizon. The higher investment return assumption (discount rate) reduces the present value of future benefits or actuarial accrued liability.

A report by the Pew Center on the States noted that "on average, states have only put aside 7.1 percent of the assets needed to adequately fund their retiree health care liabilities. Twenty states have not set aside any funds."[3] Governments, at both state and local levels, are struggling to meet required payments to fund just pensions notwithstanding OPEB benefits. Until recently, the liability for future OPEB had been largely ignored and unreported. Unfunded OPEB liabilities, while not unique to Rhode Island are real and without funding, will only grow significantly.

Consistent with the conclusions outlined herein that locally administered pension plans are at risk, locally-administered OPEB plans should likely be viewed in the same light. An opportunity exists to restructure plan design and benefit delivery before each community creates a trust and begins to accumulate assets to fund future benefits.

One option would be for the State to create a pooled investment trust for other post-employment benefits. This would serve as a common investment vehicle for municipalities that are accumulating assets to meet the future cost of OPEB. A pooled OPEB investment trust administered by the State could provide a well diversified, professionally managed investment option for Rhode Island municipalities. It is likely that the investment return of the pooled trust could exceed the return obtained by a municipality acting individually, particularly for smaller communities that are just beginning to accumulate assets for OPEB.

Another option is to consider a statewide OPEB health care plan (an agent–multiple employer plan under State administration but without State funding responsibility) that could decrease overall costs through economies of scale, reduce administrative costs and enhance bargaining position with health insurers. A statewide OPEB plan would also be consistent with the goal of merging locally administered pension plans into the state administered MERS plan, as well as, initiatives to foster a statewide healthcare contract for teachers and municipal employees. Further, plan design and plan benefits vary widely among municipalities–a common state administered plan could standardize OPEB benefit provisions among municipalities.

[3] Pew Center on the States – *The trillion dollar gap – Underfunded state retirement systems and the roads to reform*- February 2010

Rhode Island Municipalities' Other Post-Employment Benefit (OPEB) Plans at June 30, 2009

Municipality	Type of Plan	ARC	Contributions	% of ARC	Net OPEB Obligation (Asset)	Date of Valuation	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liablity	Funded Ratio
Barrington	Trust Fund	$ 2,597,104	$ 2,147,711	82.70%	449,393	6/30/2009	$ 3,513,802	$ 21,471,689	$ 17,957,887	16.4%
Bristol	Trust Fund	844,000	889,043	105.34%	(377,778)	7/1/2008	1,675,000	12,862,000	11,187,000	13.0%
Burrillville	Pay-as-you-go	129,436	106,868	82.56%	22,568	7/1/2008	-	1,675,408	1,675,408	0.0%
Central Falls	Pay-as-you-go	1,963,061	1,394,009	71.01%	569,052	7/1/2008	-	30,693,955	30,693,955	0.0%
Charlestown [21]	Trust Fund	385,000	636,782	165.40%	(251,782)	7/1/2006	-	3,391,000	3,391,000	0.0%
Coventry	Pay-as-you-go	1,200,000	872,000	72.67%	328,000	7/1/2009	-	12,835,000	12,835,000	0.0%
Cranston - *Public Safety*	Trust Fund	4,047,835	3,273,843	80.88%	500,677	7/1/2009	397,327	50,533,441	50,136,114	0.8%
- Board of Education	Pay-as-you-go	3,504,375	2,288,090	65.29%	1,642,251	7/1/2008	-	35,821,039	35,821,039	0.0%
Cumberland	Pay-as-you-go	3,743,000	1,569,191	41.92%	2,173,809	7/1/2008	-	46,872,000	46,872,000	0.0%
East Greenwich	Pay-as-you-go	1,262,545	276,218	21.88%	986,327	7/1/2008	-	10,504,613	10,504,613	0.0%
Glocester	Pay-as-you-go	192,932	152,619	79.11%	105,315	7/1/2008	-	2,199,146	2,199,146	0.0%
Jamestown - *Police Plan*	Pay-as-you-go	233,368	90,500	38.78%	104,126	1/12008	-	1,874,075	1,874,075	0.0%
- School Plan	Pay-as-you-go	905,779	348,153	38.44%	420,382	7/1/2007	-	13,129,596	13,129,596	0.0%
Johnston	Pay-as-you-go	18,202,814	4,397,410	24.16%	13,805,404	6/30/2008	-	226,245,500	226,245,500	0.0%
Lincoln	Pay-as-you-go	1,907,362	907,686	47.59%	999,676	6/30/2009	-	23,939,601	23,939,601	0.0%
Middletown [22]	Pay-as-you-go	1,535,690	491,806	32.03%	n/a	7/1/2007	-	21,552,897	21,552,897	0.0%
Narragansett	Pay-as-you-go	6,406,441	1,384,467	21.61%	5,021,974	7/1/2008	-	70,365,417	70,365,417	0.0%
Newport	Trust Fund	10,238,391	11,099,555	108.41%	9,037,637	7/1/2008	4,464,395	142,838,552	138,374,157	3.1%
North Kingstown	Pay-as-you-go	2,290,415	941,768	41.12%	1,348,647	7/1/2007	-	25,294,765	25,294,765	0.0%
North Providence	Pay-as-you-go	4,039,000	1,646,000	40.75%	2,426,000	7/1/2008	-	52,758,000	52,758,000	0.0%
North Smithfield	Pay-as-you-go	538,195	323,283	60.07%	478,262	7/1/2007	-	5,793,469	5,793,469	0.0%

Rhode Island Municipalities' Other Post-Employment Benefit (OPEB) Plans at June 30, 2009

Municipality	Type of Plan	ARC	Contributions	% of ARC	Obligation (Asset)	Date of Valuation	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liablity	Funded Ratio
Pawtucket	Pay-as-you-go	$ 31,011,620	$ 10,032,096	32.35%	$ 40,390,667	7/1/20008	$ -	$ 437,601,577	$ 437,601,577	0.0%
Portsmouth - *Town Plan*	Pay-as-you-go	1,569,039	462,590	29.48%	1,106,449	7/1/20008	-	13,026,759	13,026,759	0.0%
- School Plan	Pay-as-you-go	511,670	299,602	58.55%	212,068	7/1/2007	-	4,514,458	4,514,458	0.0%
Providence [25]	Pay-as-you-go	43,147,000	35,022,000	81.17%	13,047,000	7/1/2008	-	593,903,000	593,903,000	0.0%
Scituate	Pay-as-you-go	529,719	138,475	26.14%	391,244	3/31/2009	-	4,713,768	4,713,768	0.0%
Smithfield [25]	Pay-as-you-go	2,324,739	1,455,607	62.61%	869,132	7/1/2009	-	26,277,276	26,277,276	0.0%
South Kingstown [23]	Trust Fund	1,694,400	1,426,200	84.17%	268,200	7/1/2007	-	15,988,000	15,988,000	0.0%
Tiverton	Pay-as-you-go	3,175,366	1,255,056	39.52%	1,920,310	7/1/2008	-	34,838,000	34,838,000	0.0%
Warren [24]	Trust Fund	383,807	-	0.00%	508,894	7/1/2007	700,000	3,018,423	2,318,423	23.2%
Warwick - *City Plan*	Pay-as-you-go	18,856,800	6,705,018	35.56%	23,622,803	7/1/2009	-	210,272,745	210,272,745	0.0%
- School Plan	Pay-as-you-go	5,553,088	1,692,036	30.47%	7,801,248	7/1/2009	-	47,479,237	47,479,237	0.0%
West Warwick	Pay-as-you-go	8,868,698	3,096,416	34.91%	5,772,282	7/1/2008	-	136,587,286	136,587,286	0.0%
Westerly - *Police Plan*	Trust Fund	433,200	366,250	84.55%	66,950	7/1/2008	7,301,108	11,319,636	4,018,528	64.5%
- School Plan	Pay-as-you-go	532,439	419,054	78.70%	113,385	7/1/2008	-	1,576,533	1,576,533	0.0%
Regional School Districts										
Bristol-Warren	Pay-as-you-go	3,780,721	2,410,915	63.77%	2,744,751	7/1/2007	-	47,863,133	47,863,133	0.0%
Chariho	Pay-as-you-go	245,900	188,393	76.61%	130,862	7/1/2008	-	2,018,516	2,018,516	0.0%
Exeter-West Greenwich	Pay-as-you-go	397,094	255,401	64.32%	141,693	7/1/2008	-	3,554,702	3,554,702	0.0%
Foster-Glocester	Pay-as-you-go	403,172	376,044	93.27%	27,128	7/1/2009	-	3,535,431	3,535,431	0.0%
	Totals:	$ 189,585,215	$ 100,838,155	53.19%	$ 138,925,006		$ 18,051,632	$ 2,410,739,643	$ 2,392,688,011	0.7%

see notes 2, 18, 19, and 20 on page 41

OVERSIGHT OF LOCALLY ADMINISTERED PENSION and OPEB PLANS

State of Rhode Island General Laws

> *Rhode Island General Laws Section 45-10-15 requires the following:*
>
> - For any audit year in which a municipality contributes materially less than 100% of the annual required contribution to its pension plan(s) as reported in accordance with GASB Statement Number 27 "Accounting for Pensions by State and Local Governmental Employers" or any successor statement, the municipality shall submit to the Auditor General and the state Director of the Department of Revenue:
>   - the municipality's most recent actuarial study of the plan(s), and
>   - management's recommendations for assuring future payments equal to the annual pension cost (APC).
> - This information must be submitted within three (3) months of completion of the audited financial statement.

The General Laws of the State of Rhode Island contain few provisions regarding locally administered pension and OPEB plans since the plans are established and governed by local ordinance or municipal charter provisions. Section 45-10-15 of the Rhode Island General Laws, however, requires a municipality to submit certain information when they have not contributed 100% of their annual required contribution.

The Office of the Auditor General requests all municipalities contributing materially less than 100% of their ARC to develop a plan to assure future payments equal to the ARC. Although these municipalities generally develop corrective action plans, some are inadequate and problems often exist with plan implementation. Some municipalities have repeatedly failed to comply with their corrective action plans by either not appropriating the contribution stipulated or not contributing the amount appropriated if budgetary shortfalls occur elsewhere. The current law lacks enforcement provisions. Because of the flexibility locally administered plans can exercise, pension contributions (to locally-administered plans) are often cut when budgetary shortfalls arise.

Many municipalities have difficulty in meeting the ARC due to constraints on their ability to raise property taxes (the primary source of revenue for most municipalities) and recent cuts in state aid to municipalities. A schedule on page 31 compares the annual required contributions for all pension and OPEB plans to each municipality's property tax levy.

While municipalities are generally submitting the plans, in actuality this process has not resulted, overall, in a significant increase in the percentage of the annual required contribution funded by municipalities.

No oversight measures are currently specified in the General laws with respect to other post-employment benefit programs administered by municipalities.

SUMMARY AND CONCLUSIONS

Status of the Plans

Many of the pension plans administered by Rhode Island municipalities have deteriorated further since our last report in July 2007. In several cases, municipalities have continued to contribute less than 100% of the annual required contributions. As a result, funded ratios have continued to decline; thereby, leaving some of these plans in perilous condition. At $2.4 billion, the newly disclosed unfunded liability for other post-employment benefits provided by municipalities ("OPEB" – generally retiree healthcare), overshadows the collective unfunded liability for all locally administered pension plans which now totals $1.9 billion.

The number of pension plans considered to be at risk has grown from 21 to 23 and their collective funded ratio decreased from 45%, as reported in July 2007, to 43% currently. Of the 23 (out of 36) locally administered pension plans considered to be at risk, seven were considered most at risk because the plans were significantly underfunded and annual contributions were significantly less than actuarially determined amounts. For twelve other plans, annual contributions were more than 80% of annual required amounts; however, the plans were still significantly underfunded. Despite a funded ratio greater than 60%, four additional plans were considered at risk because annual contributions were generally declining over a multi-year period. The collective unfunded liability for locally-administered pension plans has increased $300 million from $1.6 billion in July 2007.

The collective annual required contributions (for pensions) for all municipalities was approximately $295 million for fiscal 2009 of which $161 million related to locally administered plans. The annual required contribution for OPEB plans was $190 million. The total annual cost to municipalities (if 100% of the required contributions were made) was $485 million. The amount actually funded was approximately $367 million.

For nine communities, the annual required contribution for pensions and OPEB (if 100% were made) represents 25% or more of the community's fiscal 2009 property tax levy – a significant and likely unsustainable burden (see table on the next page). In Central Falls, Pawtucket, and Johnston the annual required contributions (for pensions and OPEB) were 57%, 59%, and 47%, respectively, of their annual property tax levy.

Governmental employers must now recognize OPEB costs on an actuarial basis. These costs are almost totally unfunded - the collective unfunded liability for OPEB benefits is $2.4 billion and assets to cover less than 1% of the actuarial accrued liability have been set aside.

There are currently no state administered OPEB plans for municipalities – all municipal OPEB plans are locally administered. Consistent with the conclusions outlined herein that locally administered pension plans are at risk, locally administered OPEB plans should likely be viewed in the same light. An opportunity exists to restructure plan design and benefit delivery before each community creates a trust and begins to accumulate assets to fund future benefits.

Rhode Island Municipalities - Fiscal 2009
Total Annual Required Contribution as a Percentage of the Total Property Tax Levy

Municipality	2009 TAX LEVY(a)	State Administered Pension Plans: ERS (Teachers) 2009 ARC (c)	State Administered Pension Plans: MERS (Other ee's) 2009 ARC	Local Pension Plans 2009 ARC (b)	Local OPEB PLANS 2009 ARC	Total 2009 ARC All Plans (b)	(b) Total ARC as a % of Tax Levy
Barrington	$ 49,602,859	$ 2,508,369	$ 891,007	$ -	$ 2,597,104	$ 5,996,480	12.1%
Bristol (26)	33,426,741	1,663,852	751,952	640,220	3,251,185	6,307,209	18.9%
Burrillville	21,011,173	1,610,087	526,619	-	129,436	2,266,142	10.8%
Central Falls	10,495,379		183,695	3,839,164	1,963,061	5,985,920	57.0%
Charlestown (26)	19,708,925	648,757	641,182	-	454,221	1,744,160	8.8%
Coventry	59,106,603	4,346,179		5,866,170	1,200,000	11,412,349	19.3%
Cranston	153,150,874	7,671,187	2,927,939	20,462,365	7,552,210	38,613,701	25.2%
Cumberland	52,957,872	3,063,534	913,123	1,135,722	3,743,000	8,855,379	16.7%
East Greenwich	39,575,719	1,637,537	683,608	-	1,262,545	3,583,690	9.1%
East Providence (2)	84,729,950	3,112,251	2,998,698	6,256,502	n/a	12,367,451	n/a
Exeter (18) (26)	11,672,749	802,598	117,440	-	190,129	1,110,166	9.5%
Foster (d) (18) (26)	9,879,531	542,538	233,710	-	131,918	908,166	9.2%
Glocester (26)	19,541,335	1,099,881	554,394	-	464,186	2,118,461	10.8%
Hopkinton (20) (26)	15,651,281	825,523	474,041	-	88,081	1,387,646	8.9%
Jamestown	17,562,744	607,713	596,706	139,929	1,139,147	2,483,495	14.1%
Johnston	61,791,239	2,557,000	1,119,000	7,042,000	18,202,814	28,920,814	46.8%
Lincoln	49,267,068	2,788,083	193,244	612,327	1,907,362	5,501,016	11.2%
Little Compton (18)	9,425,477	204,112		424,375	n/a	628,487	6.7%
Middletown	38,485,603	2,023,597	801,826	2,715,725	1,535,690	7,076,838	18.4%
Narragansett	40,209,538	1,149,017		2,539,963	6,406,441	10,095,421	25.1%
Newport	58,945,707	1,730,441	1,807,463	5,716,748	10,238,391	19,493,043	33.1%
New Shoreham (18)	6,932,888	253,398	244,413	-	n/a	497,811	7.2%
North Kingstown	62,565,154	3,189,857	2,962,743	-	2,290,415	8,443,015	13.5%
North Providence	53,303,326	2,835,000	804,393	1,529,633	4,039,000	9,208,026	17.3%
North Smithfield	24,190,127	1,224,753	201,935	-	538,195	1,964,883	8.1%
Pawtucket	81,691,526	6,618,257	1,343,881	8,907,828	31,011,620	47,881,586	58.6%
Portsmouth	40,361,114	1,707,253		2,346,316	2,080,709	6,134,278	15.2%
Providence	287,279,179	18,200,000		51,609,000	43,147,000	112,956,000	39.3%
Richmond (20) (26)	13,852,385	830,363	324,968	-	88,598	1,243,929	9.0%
Scituate	23,459,585	1,328,090	320,416	472,897	529,719	2,651,122	11.3%
Smithfield	44,064,149	1,927,304	963,512	2,092,019	2,324,739	7,307,574	16.6%
South Kingstown	63,726,992	3,317,000	1,368,300	-	1,694,400	6,379,700	10.0%
Tiverton	31,230,365	1,499,666	249,108	711,225	3,175,366	5,635,365	18.0%
Warren (26)	19,508,191	949,392	779,192	-	1,757,343	3,485,927	17.9%
Warwick	195,989,706	9,658,194		28,366,706	24,409,888	62,434,788	31.9%
Westerly	58,931,924	2,920,341	40,802	1,869,462	965,639	5,796,244	9.8%
West Greenwich (18) (26)	16,092,264	873,671	373,070	-	206,965	1,453,707	9.0%
West Warwick	49,395,487	2,798,442		4,676,096	8,868,698	16,343,236	33.1%
Woonsocket (19)	42,128,184	4,456,455	2,035,073	1,518,900	n/a	8,010,428	n/a
	$ 1,970,900,913	$ 105,179,693	$ 28,427,453	$ 161,491,292	$ 189,585,215	$ 484,683,653	24.6%
			$ 295,098,438				

(a) source - Division of Municipal Finance
(b) includes contributions to all plans including pay-as-you-go plans and those where an annual required contribution is not actuarially determined (as is the case with plans administered by an employee union)
(c) excludes State's contriubtion for teachers retirement
(d) 2009 ARC amounts for Foster are based on a draft audit report for fiscal year 2009

Causes

Underfunded pension and OPEB plans are not unique to Rhode Island. The issues associated with defined benefit plans–both public and private–have received significant attention in light of increasing actuarial liabilities for future benefits driven in large part by employees retiring earlier and living longer as well as recent investment losses.

The annual cost to fund the various pension and OPEB plans of the municipalities is significant. It threatens to have a disproportionate impact on a municipality's overall financial situation and may be unsustainable in light of property tax limits and current reductions in state aid. Failure to fund these plans adequately and in compliance with actuarial requirements in the past is the single largest reason why current costs are so high.

Various other structural issues contribute to or facilitate the poor funded status of many locally-administered plans. Clearly, local administration of the plans allows flexibility in defining the benefit structure of the plan and also the timing and actual amounts contributed to the plan. In many instances that flexibility has resulted in generous benefits and failure to make annual required contributions. Additionally, local governments typically have a short-term, annual budget perspective which is often inconsistent with the long-term perspective required of pension plan stewards.

In contrast, all Rhode Island municipalities are making 100% of their annual required contribution for teachers to the state-administered Employees Retirement System. Similarly, all Rhode Island municipalities that participate in the Municipal Employees' Retirement System are making 100% of their annual required contribution and are adhering to the established benefit structure outlined in the State's General Laws. The MERS plan is 93% funded. In these instances, the municipality must fund required amounts – the General Laws allow for offset of state aid to local governments if the municipality is delinquent in making required pension contributions to the state-administered pension plans. The same fiscal discipline is not forced upon a municipality with regard to its locally-administered pension plan.

The costs for locally-administered plans, as measured by annual required contributions, are generally much more significant than costs for employees participating in the Municipal Employees' Retirement System (see table on page 31).

When a municipality also administers a pension plan for certain of its employees, retiree benefits are often renegotiated through the collective bargaining process. Oftentimes, the "cost" of the contract focuses on the near term cash outflows for salary increases and health care but ignores the long-term and perhaps more substantial costs related to enhanced pension benefits. An example that was publicized due to recent court action involved Johnston police officers who are allowed to discharge accumulated sick leave just prior to retirement and have such time count towards pension service credits. These types of benefit provisions increase the overall costs of the locally administered pension plans and also make it more difficult for such plans to be brought into the state administered MERS plan due to inconsistency in benefit provisions.

We did not compare, in detail, the benefits offered by the various locally-administered OPEB plans. However, in general, the municipal plans appear to be more generous than the State's OPEB plan for its employees. For example, under the municipal OPEB plans, full spousal and dependent coverage is common and a retiree co-pay is generally not required. In comparison, the State's OPEB plan covers only employees (spousal and dependent coverage is available on a buy-in basis at full cost) and a 20% retiree co-pay is required for all employees retiring after October 1, 2008 (co-pay percentages for earlier retirees were determined based on years of service).

Due to their size, locally-administered plans are at a disadvantage in investing plan assets with the aim of maximizing returns yet reducing risk exposure through diversification. The smaller size of the investment portfolios associated with the self-administered plans makes it more difficult to effectively diversify assets and fully participate in all types of investment options. With some exceptions, investment returns of the self-administered plans are less than the returns earned by the State retirement system. Further, the cost of investing and the overall administrative costs of the self-administered pension plans are likely higher because of the lack of economies of scale.

Conclusions and Impact on Municipalities

Pension plans administered by Rhode Island municipalities are of concern because so many are considerably underfunded. The principal concern, given the poorly funded status of the plans, is ensuring that adequate funds will be available to meet benefit payments promised to retirees. As an example, assets available within the City of Cranston's Police and Fire Employees Retirement System are only sufficient to make pension benefit payments to retirees for approximately two years.

Of equal importance is the negative impact these self-administered plans are having on the overall financial health of communities when not properly funded. Bond rating agencies do focus on how well a community is managing its pension and OPEB obligations. Consequently, this can affect the ratings assigned to debt of the municipality which directly impacts a community's borrowing costs.

Many municipalities are challenged to contribute at required levels, a necessary component to eventually reduce unfunded liabilities. Improving the funded status of these plans presents a significant hurdle to many communities that are already challenged to meet their obligations within state mandated property tax limits and reductions in state aid to municipalities.

OPEB liabilities warrant the same attention and funding commitment as those accruing from pension benefits and represent another significant financial challenge for municipalities. While the collective OPEB liabilities of the municipalities are alarming due to both dollar amount and recent disclosure, there may be opportunities to restructure benefits and plan design to effect savings for municipalities.

Because many of the locally-administered pension plans have a higher proportion of retirees and fully-vested employees, making changes to benefit provisions are problematic. In a number of instances, newer employees were moved to the MERS plan but retirees and hires before a certain date were left in the locally administered plan. While merging locally-administered plans into MERS is still recommended, changes in benefit provisions are necessary to yield significant cost savings.

Realistically, fully funding these plans in the near term is unlikely. There is no single solution to the problem of underfunded pension and OPEB plans and the attendant high costs of providing those benefits. A combination of initiatives will likely be required to decrease the risk that plans (1) will be unable to meet their benefit obligations to retirees and (2) continue to negatively impact a community's overall fiscal health. Some of the following recommendations and initiatives are already occurring or under consideration; others may warrant attention and consideration:

- Commit to funding the plans consistently at required levels;

- Reexamine benefit provisions within the locally-administered pension and OPEB plans;
- Explore options for pooled investments to enhance investment performance and to reduce costs;
- Merge plans into the Municipal Employees' Retirement System where possible;
- Revise the benefit structure within the Municipal Employees' Retirement System similar to changes adopted for teachers and state employees within the Employees Retirement System;
- Consider other retirement plan options for new hires (e.g., "hybrid" or defined contribution plans);
- Create trusts for OPEB benefit plans and fund future benefits – this will allow use of a more advantageous investment return assumption (discount rate) thereby lowering unfunded liabilities and annual required contributions; and
- Consider a state-administered agent multiple-employer OPEB plan for municipalities with a common benefit structure and a common health insurance provider/administrator.

These recommendations and/or matters warranting further legislative deliberation are outlined more fully on the following pages.

Current Recommendations for Municipalities

Recommendations 1-5 were included in our July 2007 report and remain valid. Recommendation 6 is new and reflects the impact of recently disclosed OPEB liabilities by municipalities.

1. Contribute no less than 100% of the annual required contribution (ARC) to locally administered pension plans. When current contribution levels are less than 100% of the ARC, comply with General Law section 45-10-15, and submit a plan to the Auditor General and Director of the Department of Revenue to reach a funding level that is equal to 100% of the annual required contribution. Once a plan has been developed and adopted, adhere to the funding plan provisions.

2. Earmark unexpected revenues and/or budget surpluses for making supplemental contributions to any underfunded locally administered pension plan.

3. Merge plans into the Municipal Employees' Retirement System (MERS) or pursue moving active members now covered by locally-administered pension plans to MERS.

4. Consider increasing employee contributions to the locally administered pension plans to lessen the impact of increased contribution rates to employers.

   - *Proposed legislation has been introduced to amend the general laws to increase the employee contribution rate for members of MERS.*

5. Consider alternatives to defined benefit plans for new hires such as defined contribution and "hybrid" plans to control municipal retirement plan costs. These are attractive since once the required employer contribution is made to the defined contribution plan, the employer has no further liability. One of the primary benefits of a defined-contribution plan, from a government employer's perspective, is that it provides a great deal of stability since contribution levels are known in advance and do not change much from year to year. This is in sharp contrast to the volatility in contribution levels experienced under defined-benefit plans. Additionally, since defined contribution plans are more portable to the employee, some believe that defined contribution plans are beneficial in recruiting workers since the typical long vesting provisions of governmental defined benefit plans can be a disincentive in today's increasing mobile workforce.

6. Adopt a plan to begin funding other post-employment benefits (OPEB). Review benefit provisions in light of the known actuarial costs of the plan. Revise benefit provisions as needed to ensure that the OPEB plan is sustainable and can be funded on a reasonable and consistent basis.

   - *Proposed legislation has been introduced to amend the general laws to require a minimum age before eligibility for municipal post-retirement health, dental, life or other insurance benefits and also require a minimum co-pay of 20%. This would apply to collective bargaining agreements entered into after the effective date of the legislation.*

Prior Recommendations (July 2007 report)

- Prepare a fiscal note detailing the impact on contribution rates and funded status of a locally administered pension plan when pension benefits are affected by new collective bargaining agreements. The fiscal note should provide the governing body approving the contract with sufficient information to ascertain the full cost of the proposed collective bargaining agreement.

  Status: General Law section 45-5-22 "Collective bargaining fiscal impact statements" was enacted which requires the preparation of a fiscal impact statement by the city or town prior to executing any collective bargaining agreement.

Matters Warranting Further Legislative Deliberation

The issues impacting the fiscal health of locally administered pension plans are multi-faceted and long-term in nature. It is likely that actions to address the issues will involve studies of various options and occur over a period of time rather than immediately. Based on our review, we have outlined various matters that we believe warrant consideration as options to ensure that promised pension benefits can be provided to employees/retirees without undermining the fiscal health of the sponsoring municipality.

1. *Create a pooled investment trust for locally administered pension plans to improve investment performance*

Self-administered plans lack advantage in investing accumulated pension plan assets to maximize returns yet reduce risk exposure through diversification. The smaller size of the investment portfolios associated with the self-administered plans makes it more difficult to effectively diversify assets and fully participate in all types of investment options. With some exceptions, investment returns of the self-administered plans are less than the returns earned by the State retirement system. Further, the cost of investing and the overall administrative costs of the self-administered pension plan are higher because of the lack of economies of scale.

Optimally, locally administered plans should be merged into the State administered MERS plan – this option best addresses all the concerns associated with the locally administered plans. If these efforts are unsuccessful, a pooled investment trust, administered by the State, should be explored to optimize the advantages of a professionally managed, well-diversified investment option. With a pooled investment trust, the assets of locally administered pension plans are commingled for investment purposes. Investment gains and losses are distributed pro-rata to each participating entity. This would allow for broader diversification of assets, thereby, mitigating risk, enhancing investment returns through exposure to a wider variety of investment vehicles and reducing costs by spreading asset management expenses over a larger base. The State could utilize the existing structure in place to invest assets of the Employees' Retirement System. Since the investment objectives of the local pooled investment trust would be similar if not the same as the ERS, the same asset allocation model and investment objectives could be followed.

It is noteworthy that the Commonwealth of Massachusetts mandated in 2007 that local pension plans with funded ratios less than 65% and ten-year average investment returns 200 basis points less than investment returns of a state administered fund would be required to transfer assets to a state administered fund for investment purposes. The local retirement boards continue to administer the plan absent control of the invested assets. Massachusetts had also legislated a long-term schedule to achieve full funding of pension plans including locally administered plans.

2. *Amend the general laws to enhance the enforcement provisions relating to communities that are not funding 100% of the annual required contribution to their locally administered pension plan and/or OPEB plan*

Due to the significant negative impact that underfunding pension and OPEB plans can have on a municipality's long-term fiscal health, additional enforcement measures may be warranted to ensure municipalities make 100% of annual required contributions to pension and OPEB plans. Existing statutory provisions (G.L. section 45-10-15) require a municipality making materially less than 100% of the annual required contribution to its pension plan to submit a plan to the Director of Revenue and the Auditor General outlining management's recommendations to assure funding of the annual pension cost. While municipalities are generally submitting the plans, in actuality this process has not resulted, overall, in a significant increase in the percentage of the annual required contribution funded by municipalities.

In past years, a bill was introduced which contained various enforcement provisions to allow the Auditor General to petition the superior court for mandatory injunctive relief and redirect state aid to the pension plan(s). These measures were not enacted in prior legislative sessions. Clearly, redirecting state aid is now more problematic due to current and expected future reductions in state aid.

If a municipality determines that it is unable to comply with the requirement to fully fund its ARC by developing a plan which increases the ARC to 100% over a reasonable period of time (e.g. a five-year period); other measures (such as those described herein) need to be explored in an effort to remedy the financial burden these pensions place on the municipality.

3. *Prevent municipalities from establishing new pension plans (other than through the Municipal Employees' Retirement System) or expanding benefits provided under existing locally administered plans*

Due to the overwhelming evidence that locally administered plans can easily become problematic due to failure to make annual required contributions and poor investment performance, creation of new locally administered pension plans should be prohibited by the General Laws. Additionally, the following measures should also be considered:

- Prohibit benefit enhancements unless a pension plan is at least 90 percent funded.

- Prohibit new employees from entering an underfunded plan — prompting employers to establish new plans with proper funding or lower benefits, or alternatively, to establish defined-contribution or hybrid plans.

- *Proposed legislation has been introduced to amend the general laws to prohibit benefits provided under a locally administered plan, and negotiated pursuant to a collective bargaining agreement entered into after enactment of the legislation, to exceed those offered through MERS.*

4. *Consider creating incentives to encourage municipalities to merge locally administered plans into the State Municipal Employees' Retirement System*

Some locally administered plans have merged with the state administered Municipal Employees Retirement System, typically by having new hires join the MERS and the prior employees remaining within the locally administered plan. The usual impediment to merging a local plan into the MERS is conforming the benefit structure of the local plan to the statutory provisions of the MERS.

Although administering the MERS with widely divergent benefit provisions for the various participating entities could be cumbersome, significant benefits such as imposing the discipline to make 100% of annual required contributions, improving investment performance, and reducing administrative costs more than outweigh any administrative disadvantages.

One incentive that could be considered would allow a local plan to merge with the MERS despite a nonconforming benefit structure. Since separate actuarial valuations are performed for each participating entity and separate contribution rates are established for each unit within MERS, a nonconforming benefit structure would not impact other participating entities.

Financial incentives are unlikely, in the near term, due to budgetary constraints and the State's own challenges in funding its pension costs for local teachers and state employees as well as post-employment health care costs for state employees.

5. *Consider a minimum funded ratio (or other measures), which if not achieved, would trigger enhanced State oversight and commencement of discussions to merge the plan into the State Municipal Employees' Retirement System*

A state pension oversight body could have responsibility for periodically assessing the status of locally administered pension plans and ensuring that appropriate corrective actions are taken, including requiring merger of the locally administered plan into the State Municipal Employees' Retirement System. Indicators, such as a funded ratio below a target (e.g., less than 80% funded) or continued failure to make 100% of annual required contributions, could trigger enhanced State oversight and prompt negotiations to merge the locally administered pension plan into the state administered MERS plan. The pension oversight body could also require increased employer, and possibly employee, contributions to a pension fund if its funded ratio is below 90 percent.

6. *Consider implementing a two-tiered benefit structure within MERS that is similar to the two-tiered benefit structure recently enacted for the Employees' Retirement System*

Members of the State administered Employees' Retirement System, which covers state employees and teachers are subject to a two-tiered benefit structure based on whether the member had achieved 10 years of service by July 1, 2005 (Schedule A benefits). Schedule B benefits are reduced and affect members with less than 10 years of service by July 1, 2005.

A similar two-tiered benefit structure could be implemented for members of the Municipal Employees' Retirement System (MERS). Over time, this would serve to reduce the annual required contribution to the plans as more members are covered by the reduced benefit provisions.

- *Proposed legislation has been introduced to amend the general laws to implement a revised benefit structure for MERS members similar to the changes that were made for state employees and teachers.*

7. Consider a state-administered OPEB pooled investment trust or agent multiple-employer OPEB plan

An opportunity exists to restructure plan design before each community creates a trust and begins to accumulate assets which will be invested to fund future benefits.

One option would be for the State to create a pooled investment trust for other post-employment benefits. This would serve as a common investment vehicle for municipalities that are accumulating assets to meet the future cost of OPEB. A pooled OPEB investment trust administered by the State could provide a well diversified, professionally managed investment option for Rhode Island municipalities. It is likely that the investment return of the pooled trust could exceed the return obtained by a municipality acting individually, particularly for smaller communities that are just beginning to accumulate assets for OPEB.

Another option is to consider a statewide OPEB health care plan (an agent – multiple employer plan under State administration but without State funding responsibility) that could decrease overall costs through economies of scale, reduce administrative costs and enhance bargaining position with health insurers. A statewide OPEB plan would also be consistent with the goal of merging locally administered pension plans into the state administered MERS plan. This option would also be consistent with various initiatives to foster a statewide healthcare contract for teachers and municipal employees with a common health insurer/administrative agent. Further, plan design and plan benefits vary widely among municipalities – a common state administered plan could standardize OPEB benefit provisions among municipalities.

Appendix A

EMPLOYEES' RETIREMENT SYSTEM OF THE STATE OF RHODE ISLAND

REQUIRED SUPPLEMENTARY INFORMATION

Schedules of Funding Progress

Actuarial Valuation Date		Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) - Entry Age - (b)	Unfunded AAL (UAAL) (b - a)	Funded Ratio (a / b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b - a) / c)
ERS (*State Employees*)							
6/30/2008	**	$ 2,700,368,568	$ 4,371,829,709	$ 1,671,461,141	61.8%	$ 587,500,000	284.5%
6/30/2007		2,493,428,522	4,332,888,818	1,839,460,296	57.5%	660,044,273	278.7%
6/30/2006		2,256,979,077	4,131,157,601	1,874,178,524	54.6%	644,980,127	290.6%
6/30/2005		2,163,391,323	3,843,518,875	1,680,127,552	56.3%	606,474,789	277.0%
6/30/2004		2,202,900,345	3,694,787,818	1,491,887,473	59.6%	606,087,585	246.2%
6/30/2003	±	2,267,673,016	3,517,352,031	1,249,679,015	64.5%	606,102,182	206.2%
ERS (*Teachers*)							
6/30/2008	**	$ 4,044,954,378	$ 6,705,498,005	$ 2,660,543,627	60.3%	$ 985,898,174	269.9%
6/30/2007		3,737,981,686	6,750,125,236	3,012,143,550	55.4%	959,372,837	314.0%
6/30/2006		3,394,086,565	6,444,693,666	3,050,607,101	52.7%	914,985,746	333.4%
6/30/2005		3,280,977,321	5,919,156,211	2,638,178,890	55.4%	898,051,154	293.8%
6/30/2004		3,340,527,073	5,634,195,435	2,293,668,362	59.3%	866,532,598	264.7%
6/30/2003	±	3,427,685,554	5,341,627,416	1,913,941,862	64.2%	834,642,391	229.3%
SPRBT							
6/30/2008		$ 54,927,390	$ 69,029,513	$ 14,102,123	79.6%	$ 16,698,764	84.5%
6/30/2007	*	45,996,910	60,427,947	14,431,037	76.1%	15,836,354	91.1%
6/30/2006		36,314,689	42,216,142	5,901,453	86.0%	13,474,588	43.8%
6/30/2005		29,616,896	37,510,992	7,894,096	79.0%	13,225,400	59.7%
6/30/2004		24,767,014	32,689,173	7,922,160	75.8%	11,421,880	69.4%
6/30/2003		20,966,294	28,443,717	7,477,423	73.7%	11,286,365	66.3%
JRBT							
6/30/2008	**	$ 34,670,394	$ 42,455,456	$ 7,785,062	81.7%	$ 6,601,889	117.9%
6/30/2007	*	29,630,637	35,355,326	5,724,689	83.8%	6,451,666	88.7%
6/30/2006		23,873,009	27,504,102	3,631,093	86.8%	6,313,069	57.5%
6/30/2005		19,347,372	22,250,728	2,903,356	87.0%	5,684,585	51.1%
6/30/2004		16,019,053	21,845,744	5,826,691	73.3%	5,637,865	103.3%
6/30/2003		13,270,977	18,435,395	5,164,418	72.0%	5,303,153	97.4%
MERS							
6/30/2008		$ 1,174,567,205	$ 1,266,286,829	$ 91,719,624	92.8%	$ 304,952,020	30.1%
6/30/2007		1,064,615,664	1,179,233,489	114,617,825	90.3%	298,234,571	38.4%
6/30/2006		945,876,282	1,085,648,196	139,771,914	87.1%	281,291,831	49.7%
6/30/2005		886,964,787	1,017,254,365	130,289,578	87.2%	265,123,725	49.1%
6/30/2004		879,449,653	943,536,048	64,086,395	93.2%	258,985,220	24.7%
6/30/2003		885,842,533	879,589,065	(6,253,468)	100.7%	241,201,031	(2.6)%

± Restated June 30, 2003 actuarial valuation after adopting Article 7, Substitute A as Amended

* Restated June 30, 2007 actuarial valuation after 2008 amendment to General Laws

** Reflects adoption of H5983Aaa, Article 7, Substitue A as amended enacted on June 30, 2009

Source – Fiscal 2009 audited financial statements of the Employees Retirement System of Rhode Island

End Notes regarding data sources and comparability: *Appendix B*

1. Narragansett Police (prior to 7/1/78) plan is 0.4% funded. It is not considered one of the plans at risk because it is a small pay-as-you-go plan with 13 retirees and an unfunded actuarial accrued liability of $910,493. Pawtucket Police & Fire (Pre 1974) plan is 0% funded. It is not considered one of the plans at risk because it is a small pay-as-you-go plan with 71 retirees with an average age of 83.3. Total benefits paid in fiscal 2009 were $645,382.

2. The City of East Providence has an October 31 fiscal year end; therefore, the 2009 audit report is not due until April 30, 2010, in accordance with Rhode Island General Law. The 2009 ARC and contribution amounts were provided by the City and are unaudited. The unfunded actuarial accrued liability and funded ratio for the pension plan were obtained from the most recent actuarial valuation, dated October 31, 2008. An actuarial valuation of the City's OPEB has not been completed.

3. Changes in actuarial assumptions and methods contributed to the decrease in the ARC in 2009 by $720,000 for the Coventry Municipal Employees' plan and by $2,702,000 for the Coventry Police plan.

4. The annual contribution to the Coventry School Employees pension plan is established by contract at 12.75% of salaries. An actuarial valuation is performed to calculate pension cost based on various scenarios for amortizing the unfunded actuarial liability (i.e., 30-year, 25-year, or 10-year); however, the valuations have not been adopted. The ARC reported in the 5-year ARC table on page 14 represents the pension cost based on a 30-year amortization, as reported in the actuarial valuation as of September 1, 2008. Similarly, the information on the unfunded actuarial accrued liability and funded ratio were also obtained from the actuarial valuation.

5. The City of Woonsocket issued $90 million of pension obligation bonds in fiscal 2003 to fund the actuarially determined pension obligation for the Police (pre 7/1/80) and Fire (pre 7/1/85) pension fund. For fiscal years 2004 – 2007, the plan was fully funded and no annual contributions were required. Beginning in fiscal 2008, the plan reported an unfunded actuarial accrued liability and therefore, annual required contributions were calculated for fiscal years 2008 and 2009.

6. The 2008 audit report for the Town of Westerly reported an ARC of $1,651,065 and actual contributions of 79% of the ARC. The ARC amount included the Town's contributions towards OPEB; however, the Town was not required to report OPEB in its 2008 audit report. The actuary provided the Town with an allocation of the ARC between the pension plan ($825,961) and OPEB ($825,104). The five-year ARC table on page 14 reflects only the pension share of the ARC.

7. The ARC for fiscal 2009 was obtained from the actuarial valuation of the City of Newport, dated July 1, 2007 because the information was not disclosed in the 2009 audit report. The percent of ARC contributed was calculated from the Pension Trust Funds' financial statements.

8. The audit report for the City of Pawtucket reported a combined ARC, percent of actual contributions, and net pension obligations for the two City plans (Pre 1974 Police & Fire and Post 1974 Police & Fire). We obtained the amounts specific to each plan from the July 1, 2008 actuarial valuation. Similarly, the unfunded actuarial accrued liability and funded ratio information were also obtained from the actuarial valuation because the information was omitted from the audit report.

9. Until June 30, 2006, the Smithfield Police Pension Plan covered all police officers hired prior to July 1, 1999. As of July 1, 2006, all active Smithfield police officers hired prior to July 1, 1999 were transferred to the State MERS. The funds held under the Town's plan are for members receiving retirement benefits and for terminated but vested members. The funds will be reduced by the cost to purchase annuities and employee contribution balances that have been guaranteed by an insurance company, and the liabilities covered by the Town's plan will be limited to those for inactive participants that were not guaranteed by the insurance company at the time of the discontinuance. As of October 5, 2009, the discontinuance of the Town's plan was not complete and a new plan document setting forth the liabilities to be covered by the new plan has not been finalized and adopted.

10. The actual investment rate of return was estimated for 2006 - 2009 based upon the 2006 - 2009 audited financial statements for Central Falls, Jamestown, and Smithfield Police.

11. The actual investment rate of return was estimated for 2009 based upon the 2009 audited financial statements for Providence, Coventry Municipal Employees, and Coventry Police.

12. The actual investment rate of return is reported as of calendar year ended December 31, 2009 for Cumberland and Tiverton.

13. East Providence has an October 31 fiscal year end and Scituate has a March 31 fiscal year end.

14. The actual investment rates of return for fiscal years 2005 - 2009 are reported as of December 31 for Lincoln and Narragansett.

15. The actual investment rate of return for 2008 is reported as of December 31 for North Providence.

16. The actual investment rate of return for 2008 is reported for the period January 1, 2007 – July 1, 2008 for the Coventry Municipal Employees, and Police Pension plans.

17. The actual investment rates of return for the Coventry School Employees' plan are reported as of August 31 for fiscal 2007 – 2009.

18. The following municipalities are not required to implement GASB No. 45 (OPEB) reporting requirements until their fiscal 2010 financial statements: Exeter, Foster, Little Compton, New Shoreham, and West Greenwich.

19. Woonsocket was required to implement GASB No. 45 (OPEB) reporting requirements in fiscal 2009 financial statements; however, they have not obtained an actuarial valuation of its OPEB plan.

20. Hopkinton and Richmond do not offer other postemployment benefits.

21. Charlestown created an OPEB Trust in fiscal 2009. The Statement of Net Assets reports $501,724 in funds held in trust as of June 30, 2009. The actuarial valuation was performed as of July 1, 2006 and therefore, reports $0 assets.

22. Middletown's 2009 audit reports that funds were set-aside in fiscal years 2006 - 2009 totaling $2,500,343 in a non-major special revenue fund for the purpose of funding the UAAL and ARC for the OPEB plan. In fiscal 2010, the Town plans to establish and remit the accumulated funds to an OPEB Trust, which was authorized by the RI General Assembly on June 26, 2008. In addition to the contributions set-aside to fund the UAAL and ARC, the Town also paid $1,363,519 in post-employment benefits to 174 participants in fiscal 2009.

23. South Kingstown adopted an Irrevocable OPEB Trust Fund in fiscal 2009. The Statement of Net Assets reports $512,900 of funds held in trust as of June 30, 2009. The actuarial valuation was performed as of July 1, 2007 and therefore reports $0 assets.

24. The Town of Warren reported $61,252 in other postemployment benefits (health insurance) paid on a pay-as-you-go basis to municipal retirees in fiscal 2009, but reported no contributions towards the OPEB ARC.

25. Providence and Smithfield reported $1,035,000 and $550,225, respectively, as assets set-aside for OPEB; however, these funds are not held in a Trust.

26. The ARC associated with the regional school districts' pension and OPEB plans were allocated to the participating municipalities based on their share of funding to the regional school districts.