

# **Pension Reform: House Briefing**

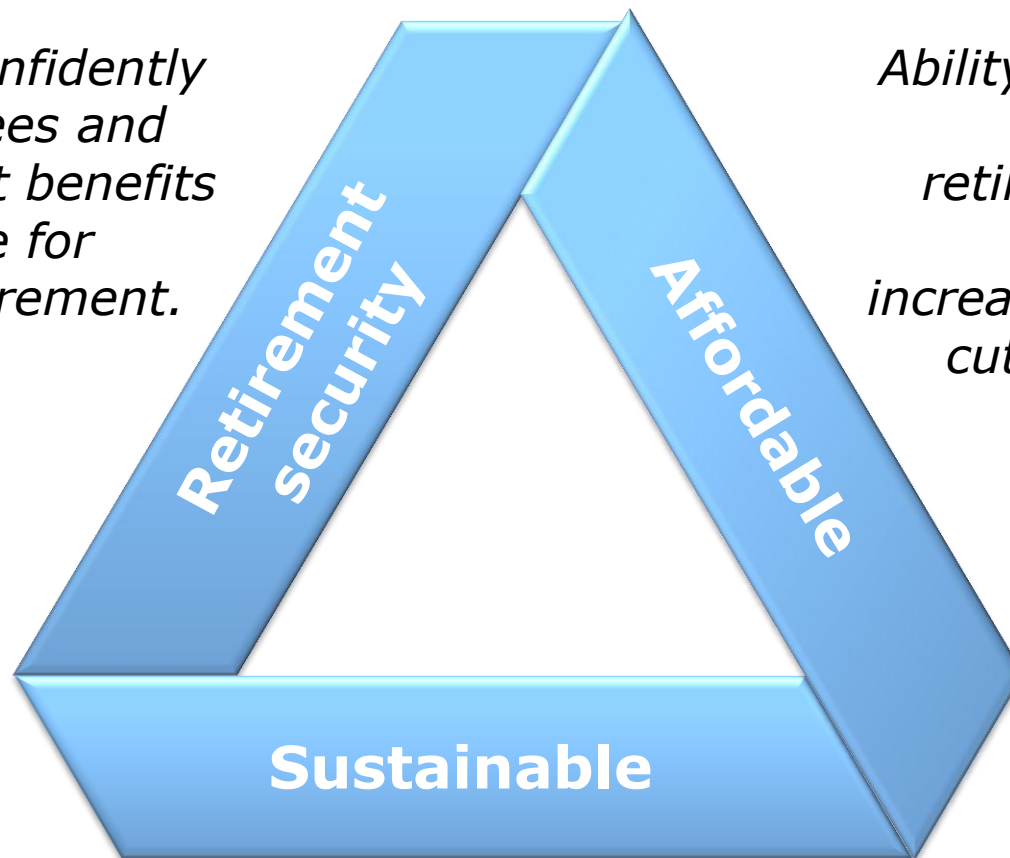
September, 2011

# Agenda

- Principles of reform
- The case for reform now
- State and municipal plan overview and funding status
- Joe Newton, GRS
- Legal issues

# We are balancing three central goals

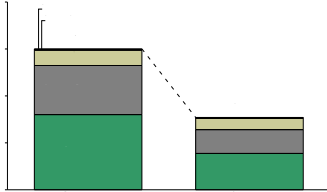
*Ability to confidently tell employees and retirees that benefits will be there for them in retirement.*



*Ability for taxpayers to support the retirement system without unfair increases in taxes or cuts in key public services.*

*Ability to fix the problem once and for all, and never return to the pension reform table again.*

# Our State retirement system is comprised of five plans



*Unfunded liabilities  
of \$7–9BN\**

**Our State system has been recognized as one of the worst funded in the country**

Source: Business Insider, April 13, 2011

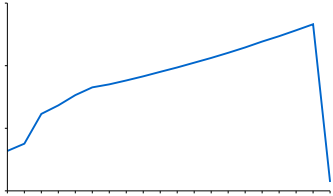
Note: All figures as of June 30, 2010, GRS Actuarial Valuation Reports - after assumption changes

\*Unfunded liability of ~\$7B assumes 7.5% rate of return, while rate of 6.2% return yields unfunded liability of ~\$9B

# State plans: funded status as of June 30, 2010

<b>Plan</b>	<b>Assets (\$B)</b>	<b>Liabilities (\$B)</b>	<b>Funded Status (%)</b>
<b>Teachers</b>	3.87	8.01	48%
<b>State Employees</b>	2.53	5.23	48%
<b>MERS</b>	1.20	1.62	74%
<b>State Police</b>	.07	.09	70%
<b>Judges</b>	.04	.05	78%

# Contributions will rise dramatically if changes are not made now

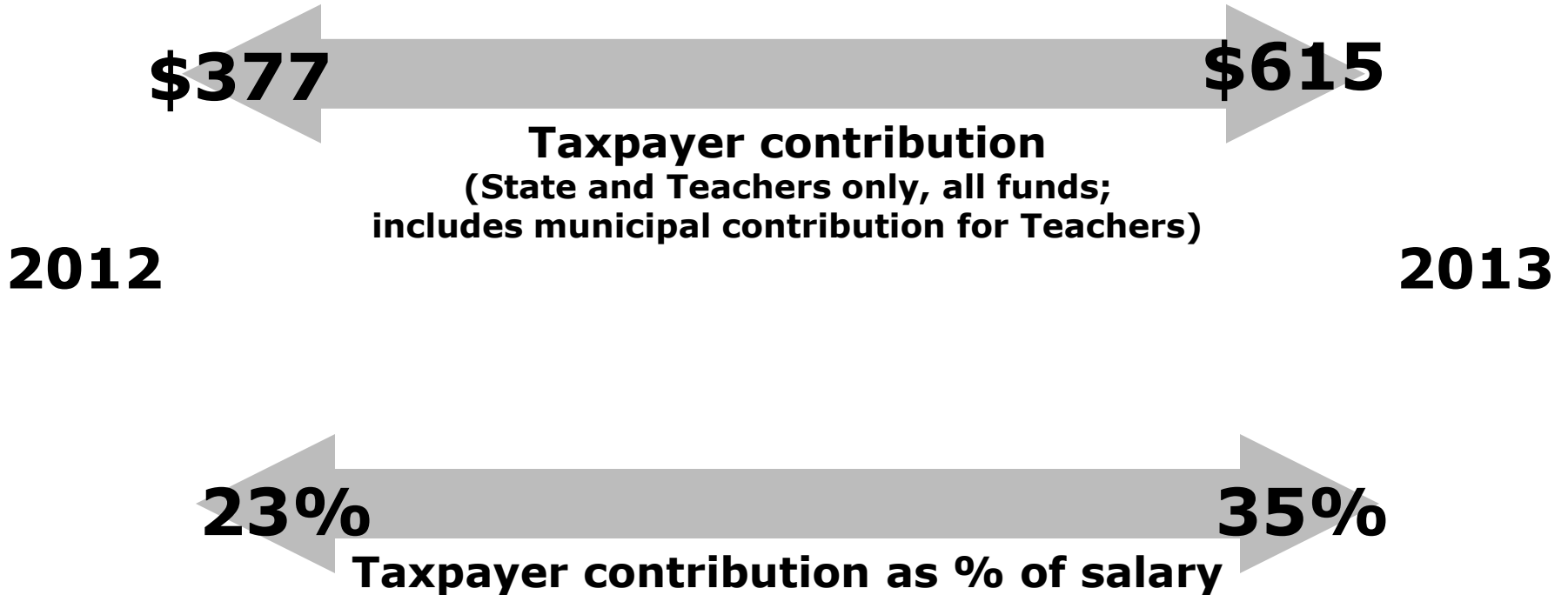


Contributions of  
**\$951M** in 2020

Contributions of  
**\$1.3B** in 2028

Contributions of  
**\$765M** in 2015

There are serious implications



# Implications to investor confidence

- In May, **Moody's lowered RI's rating outlook** from stable to negative
- The financial condition of pensions is one of many factors considered by Moody's and other rating agencies
- The unfunded pension liabilities are also a serious issue at the **municipal level**
- See Thomson Reuters September 6<sup>th</sup> brief on RI's financial outlook
- Businesses here or looking to re-locate here want stable and predictable tax structure



# In addition to the 5 State plans, there are 36 locally administered plans

## Overview: Non-MERS municipal plans

- There are 36 independent municipal plans, most collectively bargained for and not set out in state statute

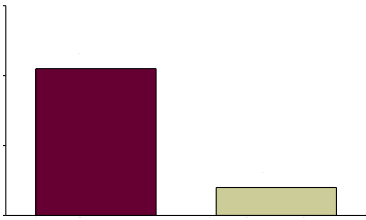
## There are pressing problems with these plans

- The collective unfunded liability for locally administered plans has increased by **\$300M to \$1.9B since** July 2007
- 23 out of 36 plans are considered **at risk**
- 18 of these plans are **<60% funded** and making **<80% of required contributions**
- Past contributions (both municipal and employee) have not been sufficient for their benefits
- **Assumptions are problematic:** investment returns, unadjusted mortality rates, etc.

## Consequences

- **Rating agencies** are closely watching how municipalities are addressing their pension and other long term liabilities
- See Thomson Reuters September 6<sup>th</sup> brief on RI's and RI's municipalities financial outlook

# The locally administered plans' unfunded liability is slightly larger than that of MERS



# Our process has been guided by several key principles

***Thus far, we have sought reforms that are:***

- **Comprehensive.**

- All issues on the table

- **Fair.**

- Everyone participates, no one group overly burdened

- **Affordable and sustainable.**

- Appropriate benefit levels to ensure retirement security for all

- **Financially responsible.**

- Reasonable assumptions and no shortcuts

- **Attractive to high quality workers.**

- Reward young or short-term employees and address vesting period

- **Recommended income replacement.**

- Provide recommended replacement income

- **Mindful of transition issues.**

- Recognize those closest to retirement and consider phase-in plan

- **Self-correcting.**

- Permanence due to automatically adjusting mechanisms

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# **Pension Reform**

## **Legal Principles and Considerations**

September 12, 2011

Office of the General Treasurer  
Mark A. Dingley,  
Deputy General Treasurer/ General Counsel

# Overview



Federal Statutory Law

Review of 50 States:  
Constitutional and Statutory  
Laws

Constitutional Contract  
Clause Analysis

Independent municipal plans

# Basic concepts

**Accrued benefits**

**Contract rights**

# Plans under discussion

- ERSRI: State Employees and Teachers
- MERS: Municipal Employees in State System
- State Police Plan
- Judicial Plan



# Federal Statutory Law

ERISA, 29 USC § 1054(g)(1) : “The accrued benefit of a participant under a plan may not be decreased by an amendment of the plan...”

BUT

ERISA, 29 USC § 1003 (b) (1): The provisions of this subchapter shall not apply to...a governmental plan.

# Federal Statutory Law

Internal Revenue Code – Employees' Retirement System of Rhode Island (ERSRI) is a qualified IRS plan under Code Section 401(a)

IRC § 411(d)(6): "A plan shall be treated as not satisfying the requirements of this section if the accrued benefit of a participant is decreased by an amendment of the plan.

BUT

IRC § 411(e)(1)(A): "The provisions of this section (other than paragraph (2)) shall not apply to.. a governmental plan..."

# Federal Statutory Law

❑ Federal Government does not provide statutory or contractual protections under Social Security

❑ Federal Government does not provide statutory or contractual protections under the Federal Employees Retirement System (FERS)

# Constitutional Provisions

Out of the 50 states, 9 states have Constitutional Provisions that specifically protect public pension benefits:

6 states (AK, HA, LA, MI, NM, TX) protect accrued benefits.

3 states (AZ, IL, NY) provide contract rights to benefits in place on the date of hire.

# State Law Overview

## Statutory Provisions

2 states provide statutory protection for public pension benefits:

- Wisconsin protects accrued benefits.
- Kentucky appears to protect benefits in place on the date of hire.

Note: New England states do not provide accrued benefit or contract right protection either by Constitutional provision or statute.

Common Law controls other states.

# Constitutional Contract Clause Analysis

Contract Clause: “No State shall ...pass any... Law impairing the Obligation of Contracts....” US Constitution Article I, section 10



## • Four Step Process

1 • Whether a contract exists;

2 • Whether a law impairs an obligation under the contract;

3 • Whether that impairment is substantial;

4 • Whether that impairment, albeit substantial, is nevertheless reasonable and necessary to fulfill an important public purpose

# Constitutional Contract Law Analysis

RI issue: Does RI pension legislation establish a contractual right with participants in its retirement system?

Winstar, 518 US 839: “unmistakability doctrine”

For a state statute to constitute a contract for purposes of the Contract Clause, there must be a clear and unequivocal indication that the legislature intended to create contractual rights.

Rationale: The principal function of a legislature is not to make contracts, but to make laws establishing the policy of the state that are inherently subject to revision and repeal.

Current Council 94 et al Pension Litigation

# Council 94 litigation: Taft-Carter Decision

- We are proceeding in all respects in accordance with the recent decision.
- Court found no evidence that the General Assembly demonstrated any “unmistakable intent” to create a contract.
- Nevertheless, the Court denied the State’s motion for summary judgment by finding an “implied in fact unilateral contract”.
- Court advised that to find a contract clause violation, 2 further questions must be addressed at trial:
  - Did prior legislation constitute a “substantial impairment”?*
  - Was the prior legislation “reasonable and necessary to carry out a legitimate public purpose”?*



# INDEPENDENT MUNICIPAL PLANS

 Caution regarding independent municipal pension plans established under collective bargaining agreements

✓ Step 1 – Whether a contract exists- is satisfied

Must evaluate under the full four step Contract Clause analysis

QUESTIONS ?