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Rhode Island Pension Reform

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On November 17, 2011 Rhode Island's General Assembly passed sweeping pension reform legislation that will affect the 66,000 active and retired participants in the Rhode Island Employees' Retirement System beginning in July, 2012. The Rhode Island Retirement Security Act of 2011 was introduced by Governor Lincoln Chafee and General Treasurer Gina Raimondo. It introduces a hybrid approach that combines conventional defined-benefit plans with 401k style plans. Other states have introduced hybrid plans, but Rhode Island will be the first to change the benefits available to current vested employees and current retired employees.

Under the Act, members of the system will contribute 5% of their pay to the defined contribution plans and 3.75% of their pay to the defined benefit plans. Currently, members contribute 8.75% to the defined benefit plans. Employers will contribute 1% to defined contribution plans with a 1% per year defined benefit pension accrual rate. The reform includes a suspension of cost-of-living adjustment increases for retirees and raises the retirement age for current workers. The pension system covers public teachers, state employees, judges and many municipal workers. Fifty-eight percent of retired teachers and forty-eight percent of retired state workers receive more money in their pensions today than they did in their final years of employment, which is creating an insurmountable burden for Rhode Island and its taxpayers.

In a statement released Friday, Fitch Ratings called the legislation "the most comprehensive measure undertaken by any of the states in recent years". Fitch views the Act's expected reduction of the unfunded actuarially accrued pension liability from \$7.3 billion to \$4.3 billion as an important credit factor. The state's actuary expects the reform provisions to bring the funded ratio for the state employees' pension system defined benefit plan from 48.4% to 59.8%. The funded ratio for the teachers' plan is expected to move from 48.4% to 61.8%. Both plans are expected to exceed 80% funding by 2032. The act is expected to save taxpayers \$4 billion over the next 24 years and save municipalities \$1 billion over the next 24 years, with a savings of \$100 million for municipalities next year alone. The state is expected to save \$168 million in 2013 due to reduced contributions to both the state employees' and teachers' pension systems.

The pension reform provides some relief to the state's municipalities, to the extent that they participate in the state's pension plans. Locally-run pension funds, many of which are in dire shape, will not be affected by the changes. There is still quite a bit of work to be done at the local levels.

Not every lawmaker who voted for the bill was happy about the decisions that were made, but most agree that the alternative of raising taxes and cutting educational funding is unacceptable. Gina Raimondo commented that with a 10% unemployment rate, it's not fair to ask taxpayers to pay for ever-increasing pensions for public workers when they may not be able to find a job themselves.

We believe that from a credit standpoint, this is a step in the right direction for Rhode Island, although S&P has indicated that they do not expect ratings to be raised in the near future. There are a lot of moving parts to the legislation and potential legal challenges to come. This is a big first step in addressing the underfunding issue for the state. The hope is that this translates into a more stable and business-friendly environment for Rhode Island and that it allows legislators to avoid significant tax increases to fund the pension deficit.