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# City of Providence

## Subcommittee on Pension Sustainability

## Pension Reform Measures and the Sustainability of the Employees' Retirement System

## Report and Recommendations
April 19, 2012

<u>Committee Members</u>:

Councilman David Salvatore, Chairman
Councilman Samuel Zurier, Vice-Chairman
Councilman Michael Correia
Councilwoman Sabina Matos
Majority Leader Seth Yurdin

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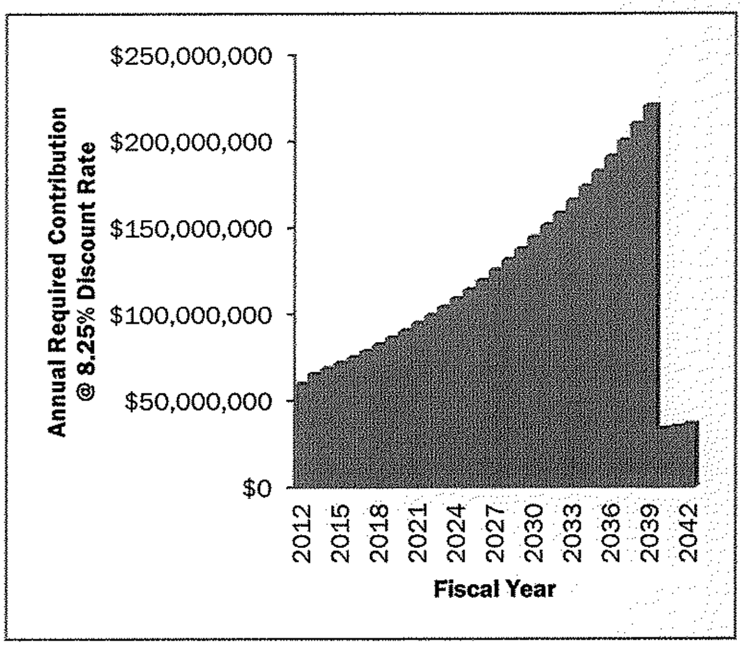
# EXECUTIVE SUMMARY

The Subcommittee on Pension Sustainability ("Subcommittee") was formed in October 2011 to address concerns about the sustainability of the City of Providence's retirement benefit system. Reform of the retirement benefits system is essential to the long term financial health of the City of Providence ("City") and the State of Rhode Island ("State"). The Subcommittee set out to perform a complete evaluation of the City's retirement benefit system and to recommend actions necessary to the effective maintenance of retirement benefits for the City's current and retired employees.

The Subcommittee's review of the retirement benefit system has included the pension system (known as the Employees' Retirement System), disability pensions, and other post-employment benefits ("OPEB"), which generally includes retiree healthcare benefits.

Consistent with its mission, the Subcommittee began its work immediately after its formation and has already made substantial progress towards evaluating the retirement benefits system. The Subcommittee has already issued several recommendations to the City Council, including the approval of ordinances adjusting the computation of pension benefits and contributions, recommending that the City Council eliminate the "elected officials pension," and amending the manner in which Council members who also serve as City employees receive credits toward their pensions.




Despite all the measures that the City and this Subcommittee have taken to reduce the City's budget shortfalls, additional measures are necessary to keep the City operating and to sustain the City's pension system.

To further address these concerns, the Subcommittee held hearings between November 14, 2011 and March 20, 2012, addressing the subject of pension sustainability and proposals for responsible reform measures. The Subcommittee heard from several witnesses, including the former State Auditor General, and representatives of the City's actuary, fiscal advisor, and auditor. The Subcommittee also heard from representatives of the unions and retirees. During the course of the Subcommittee's work, it received several recommendations for possible pension reform measures, and witnesses consistently warned that the City needed to take action with respect to the unsustainable pension and OPEB systems if the City was to stabilize its budget and its pension system.

The City's current financial situation is, by all accounts, dire and the severity of the crisis cannot be overstated. The City is facing massive and growing structural budget deficits that are destroying the City's cash flow. The City's pension system is severely underfunded and its mounting costs are contributing significantly to the City's structural deficit and cash shortage.

There are several contributing causes to the underfunding of the pension system, including: relatively high (i.e. 5% and 6% compounded) cost-of-living adjustments ("COLAs"), liberal awarding of disability pensions, retirement age eligibility, the failure to fully fund the pension system by not making the required ARC payments, individuals are retiring earlier and living longer, and life-expectancy is increasing, as well as the recent economic recession.

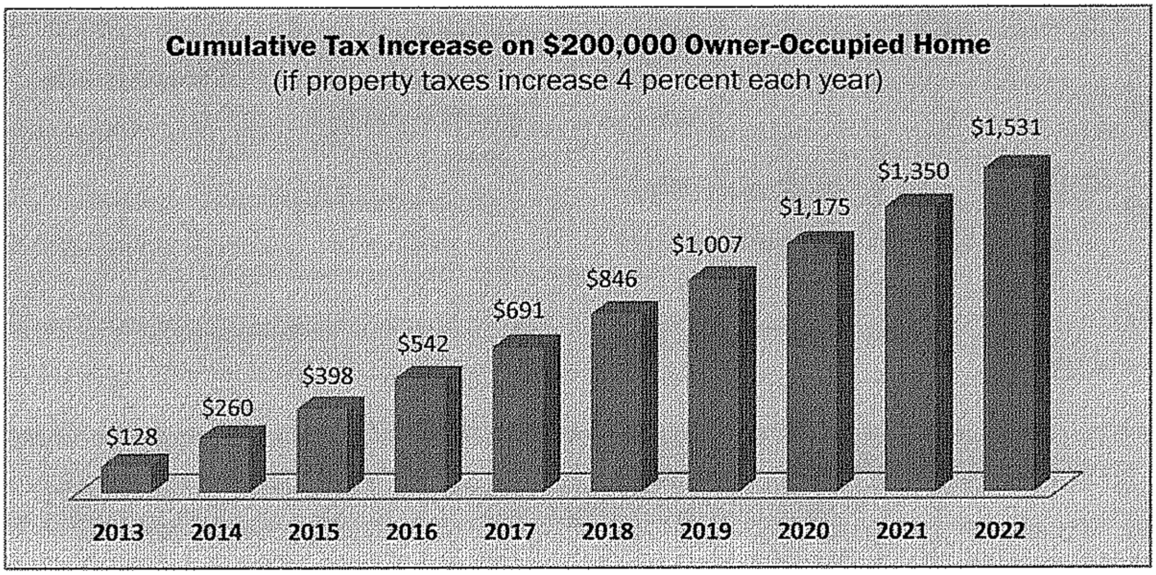
The City has no choice but to institute pension reforms to stabilize and improve the financial condition of the City. According to the Financial Review Panel Report, the City must "aggressively pursue pension reform measures to contain the growing annual required pension contributions [and] to improve the status of its pension plan to enhance its overall financial picture." If left unaddressed, the mounting cost of the pension system and OPEB liabilities will consume the City's budget, which already is running at a structural deficit.

**ARC FUNDING AS PORTION OF THE CITY BUDGET (WITHOUT REFORM)***

| | Maximum Levy Increase Allowed By Law (4.0%) | Portion of Levy Increase Required to Fund ARC | Remaining Levy Increase to Fund Other Expenditures (4.0%) | Percentage of Levy Increase Required to Fund ARC | ARC as a Percentage of City Budget |
|---|---|---|---|---|---|
| **2013** | $12,978,418 | $6,322,026 | $6,656,393 | 48.71% | 9.52% |
| **2014** | $13,497,555 | $3,348,220 | $10,149,335 | 24.81% | 9.65% |
| **2015** | $14,037,457 | $3,510,660 | $10,526,798 | 25.01% | 9.79% |
| **2016** | $14,598,956 | $3,681,022 | $10,917,934 | 25.21% | 10.12% |
| **2017** | $15,182,914 | $3,859,693 | $11,323,221 | 25.42% | 10.50% |

*Provided by the Office of the Internal Auditor

If the City runs out of funds, it will not be able to provide critical services to its residents, diminishing their quality of life and endangering their health and welfare. A lack of funds means that the City will not be able to pay its employees or its vendors; the City's ability to provide emergency services, including police and fire services, would dramatically decrease or cease altogether; the City would not be able to provide other essential services including maintaining public works or city infrastructure; the City would be forced to close even more schools; homeowners and business owners would face higher taxes; and public streets and parks would fall into disrepair. Without decisive and quick action, the City will soon run out of funds and will be forced to shut down normal operations and, ultimately, enter bankruptcy.



*Provided by the Office of the Internal Auditor

In light of the testimony received from witnesses and the pressing need to take swift measures to avert the possibility of bankruptcy for the City while continuing to sustain the pension system, the Subcommittee has concluded that the Council should take the following measures to address the City's structural deficit and to restore the health of the pension system:

1. Suspend all COLAs on all pensions until the retirement pension system reaches a funding level of 70% **($15.6 million in annual savings)**;

2. Require that contributions from all pension system members to continue beyond the current requirement of 25 years of service and, instead, continue as long as members continue to accrue pension credits **($1.5 million in annual savings)**;

3. Adjust the base pension benefit to an average of the highest 5 consecutive years of earnings during the final 10 years of a member's employment **($1.3 million in annual savings)**;

4. Broad reform of the city's disability pension system, including adjusting current benefits for accidental disability pensions for all active participants from 66⅔% of the participant's final compensation to 50% of the participant's final compensation, but in no event shall the benefit be less than the participant's service retirement allowance **($500,000 in annual savings)**;

5. Place a dollar cap on pension benefits at a level not to exceed one and one-half times the state's median household income;

6. Require all retirees and their spouses who receive health care benefits to pay a 20% co-pay of all health care costs until retirees and their spouses reach the age of 65 (at which time they will be Medicare eligible); and

7. Adopt, by ordinance, a formal process for considering and accepting an assumed rate of return on pension investments.

This report contains a summary of the testimony and evidence given to the Subcommittee, along with the Subcommittee's findings and recommendations relating to each of these recommendations.

The Subcommittee is mindful of the importance of a pension to retired and disabled employees. Maintaining a steady and secure level of post-employment income is absolutely critical for individuals receiving a pension and can have a positive effect on the economy as a whole. The recommended measures are necessary to permit the City to protect the health, safety, and welfare of its citizens, to avoid bankruptcy and to continue funding the underlying pensions of retirees. As seen in the case of Central Falls, bankruptcy can result in a devastating reduction in pension payments and is a measure that the City must avert with all available options. These measures will provide the City with additional means to avoid such a catastrophic result.

The Subcommittee recognizes these measures, although necessary to avoid shutdown and bankruptcy, will not fully alleviate the concerns surrounding the sustainability of our pension system. Other measures must still be taken to address concerns with the pension system, disability pension, and OPEB liability. The Subcommittee continues to evaluate these programs and currently is considering several reform measures to ensure a stronger, healthier, and lasting retirement benefit system.[1] The Subcommittee will issue further recommendations as warranted by further analysis.

[1] Exhibit 13, Mar. 12, 2012 Report from Buck Consultants, *Pension Change Scenarios for Providence City Council* (submitted as Mar. 13, 2012 Hearing Exhibit); Exhibit 12, Feb. 23, 2012 Report from Buck Consultants, *Alternative Changes to Discount Rate* (submitted as Mar. 13, 2012 Hearing Exhibit).

## SUMMARY OF HEARING TESTIMONY

Between February 7, 2012 and March 20, 2012, the Subcommittee held five hearings on the subject of pension sustainability and proposals for responsible reform measures. The Subcommittee heard from several witnesses, including the former State Auditor General, representatives of the City's actuary, fiscal advisor, and internal auditor, and representatives of the unions and retirees. During the course of the hearings, the Subcommittee also received several reports and presentations containing thorough analyses of the City's pension programs and fiscal status as well as reports on the sustainability of pension systems of cities and towns across the State.

The following is a summary of the testimony and evidence given during the hearings.

### February 7, 2012 Hearing

On February 7, 2012, the Subcommittee heard the testimony of Mr. Ernest Almonte, an accountant and former Auditor General of the State of Rhode Island. The summary of his testimony, as accepted by the Subcommittee, is as follows:

Mr. Almonte began his testimony with a summary of his professional qualifications and experience. Mr. Almonte previously served as the State's Auditor General for fifteen years. During that time, he was responsible for auditing the State's finances, auditing the receipt and expenditure of funds from the federal government, reviewing financial statements of the cities and towns of the State, and auditing the State's retirement accounts. Mr. Almonte is a certified public accountant, fraud examiner, government financial manager and is also certified in financial forensics. He has also served as the chairman of the American Institute of Certified Public Accountants, a professional organization of over 300,000 members. In addition, *Accounting Today* has twice named Mr. Almonte as one of the top 100 most influential people in the accounting profession and he has served as a speaker at national and international events on topics including government finance, pensions, fraud, and fiscal leadership.[2]

Turning to the substance of the testimony, Mr. Almonte emphasized that the City must understand and accept the alarming financial situation associated with its pension and OPEB liability. Although the resulting decisions facing the City are difficult and will affect the lives of many people, Mr. Almonte stressed that they are decisions that the City must make. A "lack of action will actually have a ripple effect throughout the City, to the people that live here, and to the whole State. It is that important, it is that severe."[3]

Thereafter, Mr. Almonte testified concerning the February 2011 *Report of the Municipal Finances Review Panel* (the "Review Panel Report"), which was accepted as a hearing Exhibit.[4] Mr. Almonte testified that the Review Panel Report resulted from the work of a

[2] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 2–3. Please note that all citations to the draft hearing transcripts are to unofficial draft copies produced for the Subcommittee by the City Clerk's Office. Copies of the draft hearing transcripts are attached hereto as Exhibits 1–5.
[3] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 3.
[4] The Review Panel Report is attached hereto as Exhibit 6.

committee formed by Mayor Taveras in January 2011 to review the City's financial condition and issue recommendations as to how to improve it.[5]

According to Mr. Almonte, the most significant portion of the Review Panel Report is found on page 2 of the report, which indicates the following, as of February 2011[6]:

| Budget Realities | Amount |
|---|---|
| The City's 2011 Budgetary Shortfall: | $ 28,613,000 |
| The City's 2012 Budgetary Shortfall: | $ 109,902,000 |
| The City's Unfunded Pension Liability: | $ 828,484,000 |
| The City's Unfunded OPEB Liability: | $ 1,497,451,000 |

Mr. Almonte explained that the budgetary shortfalls for 2011 and 2012 were "structural deficits," meaning that if the City fails to address this shortfall it will continue to "repeat itself year after year."[7] Mr. Almonte warned that the structural deficit together with the growing costs of the unfunded pension and OPEB liability would "destroy the City if they are not addressed."[8]

In response to Chairman Salvatore's notation that the City's current unfunded pension liability had increased to over $900 million since the issuance of the report, Mr. Almonte noted that this would only continue to grow as the pension liability compounds over time.[9]

Mr. Almonte then turned to a discussion of the City's pension liability and the impact on the City's finances. To put the City's situation in perspective, Mr. Almonte highlighted information from a report issued by the State entitled *Pension and OPEB Plans Administered by Rhode Island Municipalities* (the "Municipal Pensions Report"), which was published in September of 2011 by the Office of the Auditor General.[10] The report was entered in the hearing record as Handout 2. Mr. Almonte first noted that Annual Required Contribution (the "ARC") for the City's pension, together with the OPEB contributions, represented 51% of the City's total annual tax levy.[11] This means that over half of the City's annual tax revenue of approximately $300 million goes directly to the City's pension and OPEB obligations, leaving less than half to pay for City services.[12]

Furthermore, Mr. Almonte noted that the City's ratio of the ARC/OPEB obligation to its tax levy of 51% is "pretty close" to that of Central Falls, which is 58%. Regarding Central Falls, Mr. Almonte stated that the unfunded pension liability was "one of the main factors" that caused its bankruptcy. According to Mr. Almonte, the bankruptcy of Central Falls is not a "one-in-a-million chance. It really is the canary in the mineshaft. A warning to everyone what

[5] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 3–4.
[6] Exhibit 6, Review Panel Report, p. 2.
[7] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 5.
[8] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 5.
[9] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 5–6.
[10] The Municipal Pensions Report is attached hereto as Exhibit 7.
[11] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 9–10; Exhibit 7, Municipal Pensions Report, p. 2, 13, 15.
[12] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 9–10, 12–13.

happens if you don't fix these problems."[13] He further noted that this is "bad company to be in right now. It is a warning about how severe the problem is."[14]

Mr. Almonte discussed three recommendations from the Auditor General's office for addressing unfunded pension and OBEP liabilities. The first is for the City to commit to making progress towards funding 100% of the ARC. Mr. Almonte noted that the City currently is making about 100% of the ARC for pensions, and that this must continue for the City to reach acceptable funding levels for the pension system.[15]

Second, Mr. Almonte discussed the recommendation that the City review its locally administered benefit plan and "embark on reforming those benefits."[16] The reforms recommended include switching from a defined benefit plan, in which the City guarantees a certain benefit, to a defined contribution plan, in which the City contributes to a retirement plan without guarantee of a certain benefit.[17] Additionally, Mr. Almonte recommended that the City should consider merging into the Municipal Employees' Retirement System ("MERS"), and using local ordinances or charter provisions as the basis for its pension plan rather than collective bargaining agreements, which is the current practice.[18]

Third, and most relevant to this report, Mr. Almonte recommended that the City suspend its COLAs. In making this recommendation, he emphasized that such a suspension would not impact prior COLAs already implemented and being paid, such that recipients would see no decrease in their payments. Such action would only suspend future increases to the pension payments already received.[19]

The basis for this recommendation, Mr. Almonte explained, was the drop in the return on the investment of pension assets relative to the compounding annual COLAs. A low rate of return with relatively high, compounding COLAs results in "[s]ignificant and growing unfunded liabilities."[20] An insufficient amount of assets in the program, together with the compounding COLAs will cause the total cost of the pension system to continue to rise, even if the City makes 100% of the annual required contribution.[21]

If COLAs are left unaddressed, Mr. Almonte warned that the cost of the unfunded pension liability together with the unfunded OPEB liability would outpace growth and "totally consume [the City's] overall budget."[22] As a result, the City would "not be able to provide services." In other words, Mr. Almonte explained that most of the City's budget would go to pay for accrued pension costs, and the City would have insufficient funds to pay for other

[13] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 10.
[14] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 10.
[15] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 10.
[16] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 11.
[17] Exhibit 7, Municipal Pensions Report, p. 8.
[18] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 11.
[19] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 12.
[20] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 12–13.
[21] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 12–13.
[22] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 12–13.

essential services.[23] According to Mr. Almonte, the City's problem "is that severe and it has to be tackled now."[24]

In comparison with the City's other financial obligations, Mr. Almonte identified the compounding COLAs as "one of the largest cost drivers" facing the City.[25] As an example, Mr. Almonte noted that a 6% compounded COLA would result in a retiree's pension doubling every twelve years. Rather than allowing pensions to increase at such a rate, Mr. Almonte recommended a suspension of the COLAs and creation of a more structured plan to allow the city to project and contain future costs of the pension program.[26]

Mr. Almonte also compared the City's current funding of its pension plan to that required of private businesses. The City currently has funded only about 34% of its pension liability. According to Mr. Almonte, the required funding rate for many businesses is as high as 80%. Below that amount, many businesses must take measures to make the pension plan affordable or risk bankruptcy. With the City at only 34%, the Auditor General has labeled the City's pension as one of the "highest risk plans of the whole State."[27]

In response to a question by Vice-Chairman Zurier, Mr. Almonte stated that he did not recommend that the City re-amortize the unfunded pension liability.[28] The problem with re-amortizing the City's pension plan, said Mr. Almonte, is that pushing the repayment of these liabilities into the future will only result in the City paying more for the pension obligations over time. As an example, Mr. Almonte likened re-amortizing the pension liability to buying a car "that has a five-year life" with a "thirty year mortgage."[29] He opined that this results only in "passing ... our debt" on to future generations, requiring them to pay even more for obligations they did not incur.[30]

Furthermore, Mr. Almonte noted that simply making the current ARC payments is not enough to prevent the unfunded pension liability from bankrupting the City. According to the amortization schedule, the amount of the ARC payments will continue to increase steadily each year and will, therefore, consume a greater percentage of the budget as time goes on until fully funded in 2040.[31] As a result, Mr. Almonte does "not think that [the City] will make it that far."[32]

In response to a question by Chairman Salvatore, Mr. Almonte testified that the City cannot erase its unfunded liability simply by joining the MERS plan. If the City were to merge

[23] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 12–13.
[24] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 13.
[25] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 14.
[26] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 14.
[27] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 15.
[28] Re-amortization of the pension liability would involve extending the repayment of a debt to lower the present costs.
[29] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 16.
[30] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 16.
[31] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 17–19; Exhibit 6, Review Panel Report, p. 11.
[32] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 19.

its retirement plan with MERS, Mr. Almonte said that MERS will not pay for the unfunded portion, but would set the City's pension plan aside and require the City to make increased payments until fully funded. After all, "other cities and towns are not going to pick up [the City's] liability."[33] Rather than joining MERS and then trying to improve funding of the pension system, Mr. Almonte recommended that the City "clean up" its liability through measures such as suspension of COLAs before merging with MERS.[34]

Vice-Chairman Zurier inquired as to why the MERS plan was better funded than the City's retirement system. Mr. Almonte explained that the MERS plan, which has over twice the number of plan members than the City's plan, has significantly less unfunded liability. Even though MERS has twice as many plan members, the City's unfunded liability is almost double that of the MERS plan. Mr. Almonte said that this is a result of MERS requiring participating cities and towns to pay 100% of their ARC or face a withholding of State funds. Additionally, the number of assets under management and the lower percentage of unfunded liability allows for a greater diversification and investment of plan assets, leading to a greater rate of return and, in turn, requiring less contributions from the cities and towns.[35]

Mr. Almonte also testified that borrowing money is "not a way to solve a problem" like the one facing the City.[36] Borrowing is a "one-time fix" that cannot be used to solve a "structural, multiyear problem."[37] Typically, Mr. Almonte noted, borrowing is used to solve short-term, one-time expenditures, such as building a new school. But borrowing to solve a problem that repeats itself every year simply extends the duration of the problem without addressing the cause. Because borrowing does nothing to solve a multiyear problem, Mr. Almonte is opposed such a solution.[38]

To address the mounting cost of the pensions, Mr. Almonte recommended that the City continue to make 100% of ARC payments, suspend COLAs to control increasing costs, put additional assets into the pension plan, and review and renegotiate benefits. Re-amortization or simply making the required ARC payments, with nothing more, would only "spread the debt further out" in time, but would not address the basic problem.[39] He emphasized that "[t]his is not hopeless, this just means that [the City is] in a bad situation and [the City] needs to find another way to fix it."[40]

In addition to pension reform measures, Mr. Almonte also recommended that the City take action to address its significant and growing OPEB liability.[41] Currently, the City's

[33] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 21.
[34] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 21.
[35] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 22.
[36] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 26.
[37] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 26.
[38] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 26.
[39] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 19.
[40] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 18–19.
[41] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 6–7, 11–12.

unfunded OPEB liability is approximately $1.5 Billion.[42] What is worse, according to Mr. Almonte, is that the City has funded only approximately $1 million of its total OPEB liability, resulting in a funding ratio of less than 1%.[43] Mr. Almonte compared the amount of the City's OPEB liability with that of the State and explained that the City's liability is approximately double that of the State, with only half of the participants.[44] If the City does not address the current unfunded liability and benefit structure, these costs "will rise dramatically as health care costs go up."[45] To address these concerns, Mr. Almonte recommended reviewing the benefit levels provided to plan participants.[46]

The consequences of failing to act and simply maintaining the status quo, Mr. Almonte testified, "is a recipe for disaster."[47] If the City does not address the mounting pension costs, along with the other financial obligations crushing the City, such as the unfunded OPEB liability and structural deficit, the City "will run out of cash."[48] The City "will not be able to pay [its] bills" and will be forced to lay off employees, close schools, shut down fire stations, and take similar drastic measures, and will ultimately "be shut down."[49] Mr. Almonte observed that if the City runs out of funds and cannot meet its payroll obligations, City employees will not work and the City will be unable to provide services of any kind to its residents. Furthermore, Mr. Almonte noted that the City would not be able to maintain its infrastructure, requiring the City to put off necessary repairs, which likely would cause repairs to be more costly when finally performed. The bottom line, according to Mr. Almonte, is that if the City fails to close its structural deficit and properly fund its pension system, it "will run out of cash" and "will be a bankrupt city."[50]

Furthermore, failing to act, Mr. Almonte explained, would have effects outside of the City and throughout the State. An imminent bankruptcy or receivership would, according to Mr. Almonte, deter businesses from developing and investing in the City because of uncertainty and lack of confidence in the future of the City. This would deter people from moving to the area and have a negative effect on property values across the State.[51] Simply put, Mr. Almonte testified that doing nothing and allowing the City to fall into bankruptcy is "a terrible strategic plan for the City."[52]

[42] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 6; Exhibit 6, Review Panel Report, p. 2; Exhibit 7, Municipal Pensions Report, p. 33.
[43] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 6; Exhibit 7, Municipal Pensions Report, p. 33.
[44] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 12; Review Panel Report, pp. 16, 22.
[45] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 7, 11–12.
[46] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp 6–7, 22–24.
[47] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 24–25.
[48] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 26.
[49] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 26.
[50] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 23, 27.
[51] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 28.
[52] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 28.

**February 14, 2012 Hearing**

On February 14, 2012, the Subcommittee heard testimony from the Commissioner of Public Safety Steven Paré and then from Mike Hannah and Mike Ferri of Sullivan & Company CPA's LLP. The Subcommittee's summary of his testimony, as accepted by the Subcommittee, is as follows:

Commissioner Paré began his testimony with a brief introduction to some of the causes of the high costs associated with the disability pension system. According to him, these causes include the following: the requirement of only a relatively short period before an employee became eligible for full benefits, the difficulty of determining initial and continued eligibility for disability pensions, and a lack of mechanisms to detect and prevent abuses of the disability pension system.[53]

To respond to these and other issues facing the City, the Commissioner suggested several reform measures, including better monitoring of continued eligibility with enforcement mechanisms, the use of independent medical exams by a larger pool of medical professionals, and better assessments of the nature of an injury and its impact on the work an employee can perform.[54] The Commissioner also testified that the disability system needed to be "modernized" with better record keeping procedures, including the use of digital records.[55]

The Commissioner also recommended offsetting the amount of a disability pension if a recipient is earning other income. According to the Commissioner, disability pensions are intended to act as a safety net, but some recipients of benefits are also "gainfully employed full time."[56] Additionally, to address costs, the Commissioner recommended capping the total allowed benefit amount to 80% of pay for an active employee at an equivalent rank.[57] In some cases, the Commissioner said, disability recipients were "making almost twice as much" as an active employee in an equivalent position.[58]

In response to questions by Subcommittee members, the Commissioner agreed that the City should allow transfers of employees who become disabled but are capable of doing light work to another department within the City rather than placing that employee on full disability. This would enable the City to reduce disability pension costs and to save by not having to hire an additional employee to fill an open position.[59] Such a measure would not apply, however, to those who are fully disabled and unable to work.[60]

Finally, the Commissioner recommended that the City adopt a proven model for defining and diagnosing post-traumatic stress disorder ("PTSD"). According to the

[53] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, pp. 1–3.
[54] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, pp. 1–3.
[55] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, p. 2.
[56] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, pp. 3–4.
[57] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, p. 4.
[58] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, p. 4.
[59] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, p. 5.
[60] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, p. 5.

Commissioner, PTSD is "difficult to diagnose" and the City currently does not have the medical expertise to handle these cases properly.[61]

At the conclusion of his testimony, the Commissioner submitted a list entitled *Pensions Awarded by Year* ("Pension Award List"), which reflected the total number of firefighters and police officers receiving disability pension awards since 1989.[62]

The Subcommittee then received testimony from Mr. Hannah and Mr. Ferri of Sullivan & Company CPAs LLP ("Sullivan"). Sullivan is a local CPA firm that provides full service business, accounting, and auditing services for a broad range of clients including audits of pension systems. The City engaged Sullivan to perform an audit of certain disability pension procedures and processes.[63]

Mr. Hannah and Mr. Ferri presented a report to the Committee entitled *Independent Accountants' Report on Agreed Upon Procedures* (the "Independent Accountants' Report"), which the Subcommittee later entered as an exhibit during the March 20, 2012 hearing.[64] The Subcommittee will provide a brief summary of the Independent Accountants' Report.

The Independent Accountants' Report was produced by Sullivan after reviewing the files of disability pension recipients of the City as of August 15, 2011.[65] The City provided Sullivan with a listing of 600 current disability pensioners as of August 15, 2011, and Sullivan sampled 154 of these pensioners for the report.[66] Based on this sample, Sullivan made the following findings:

- 95% of the sampled pensioners' employee files contained a disability application.[67]
- Only 54% of the sampled pensioners' files contained documentation that the injury occurred while on duty.[68]
- 97% of the sampled pensioners' files contained some medical evidence of the disability approval process.[69] Mr. Ferri testified that this determination was made on the basis of approval letters from the plan administrator because Sullivan had difficulty locating minutes of the actual votes by the Retirement board to approve applications.[70]
- 88% of the sampled pensioners' files contained approval by the Retirement Board of the disability application.[71]

[61] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, pp. 5–6.
[62] The Pension Award List is attached hereto as Exhibit 9; see Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, p. 6.
[63] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, pp. 7–8.
[64] The Independent Accountants' Report is attached hereto as Exhibit 14.
[65] Exhibit 14, Independent Accountants' Report, pp. 1-2.
[66] Exhibit 14, Independent Accountants' Report, p. 2.
[67] Exhibit 14, Independent Accountants' Report, p. 2.
[68] Exhibit 14, Independent Accountants' Report, pp. 3-4.
[69] Exhibit 14, Independent Accountants' Report, p. 4.
[70] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, p. 10.
[71] Exhibit 14, Independent Accountants' Report, p. 5.

- In a subsample of 64 pensioners, Sullivan made various findings and observations on the accuracy of benefit calculations.[72] Mr. Ferri noted that for some, the calculations may have been inaccurate, but this is difficult to determine because of problems locating benefit calculations and payroll records for comparison.[73]
- 67% of the sampled pensioners' files contained evidence of having undergone the annual re-certification process in either 2009 or 2010.[74]

Based on the above procedures and findings, Sullivan made, inter alia, the following recommendations for improving the City's administration of the pension process:

- The City should implement a software system that will automate the pension process.
- The City should immediately begin to scan all new pensioner files onto the City's network.
- The Retirement Board should develop a checklist of documents required within each pensioner's file to standardize the process. Mr. Ferri noted that many files did not even contain sufficient documentation to determine whether the pensioner's injury occurred on duty, even though the City requires this documentation.[75] Implementing a checklist and standardized documentation would address this problem.[76]
- The City should create a central depository of all essential binding pension documents.
- The City should seek to remove any and all ambiguity currently found in the City ordinances. For example, clarification should be developed for terms such as "highest three years of compensation."
- The City should prepare a written brief when changes in City ordinances or contracts affect the Retirement Office and provide it to the Pension Administrator.
- The Retirement Office should implement and adhere to the policy of requiring two signoffs on all benefit calculations.
- The Retirement Office should cross-train all employees to further standardize the processes within the department.
- The City should commission a more comprehensive internal review of previous benefit calculations. "Although the error rate found within the sample was small, it would be prudent to expand on the sample to garner further confidence in the accuracy of the calculations."[77]
- A systematic, yearly review process should be established by the City's Internal Audit Department to ensure benefit compliance as well as the accuracy of benefit calculations.
- The Retirement Office should create a formal policies and procedures manual to be followed by all employees.[78]

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[72] Exhibit 14, Independent Accountants' Report, p. 5-8.
[73] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, pp. 13–14.
[74] Exhibit 14, Independent Accountants' Report, p. 9
[75] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, pp. 9–10.
[76] Exhibit 14, Independent Accountants' Report, p. 3.
[77] Exhibit 14, Independent Accountants' Report, p. 11; Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, p. 18.
[78] Exhibit 14, Independent Accountants' Report, pp. 10-12.

After Mr. Hannah and Mr. Ferri completed the review of their report, the Chairman stated that the Subcommittee would review the findings and collaborate with the City's Internal Auditor's Department to work towards implementing some of the recommendations and improve the disability application process.[79]

**March 6, 2012 Hearing**

On March 6, 2012, the Subcommittee heard testimony from City fiscal advisor Gary Sasse and internal auditor Matt Clarkin. The Subcommittee's summary of their testimony, as accepted by the Subcommittee, is as follows:

Mr. Clarkin and Mr. Sasse testified as to the mounting cost of the City's pension program and its impact on the City's budget and ability to sustain the pension program. They also testified regarding the increased costs of the pension program to taxpayers. Mr. Clarkin and Mr. Sasse prepared a presentation entitled *Financial Impact of Funding Pensions on Providence* (the "Financial Impact Presentation"), which was accepted as an exhibit.[80]

To compare the cost of the pension program relative to other benefit programs, Mr. Clarkin testified that the ARC payment for the pension program currently consumes over half of the City's budget for all City employee benefits, more than medical insurance costs, FICA tax, and all other employee benefits combined.[81]

Mr. Clarkin then explained the impact of the pension ARC relative to the City's deficit. According to his figures, the City's projected budget deficit for the current fiscal year is between $23 to 30 million.[82] The projected deficit for the next fiscal year is over $31 million.[83] Over the next several years after that, the deficit is projected to continue to grow dramatically from over $50 million in 2014 to over $67 million in 2017.[84] During that time, the pension ARC grows steadily as well. The current amortization schedule for the pension ARC requires the City to make payments that increase incrementally each year. The payment, which is over $55 million this year, will increase up to almost $75 million in fiscal year 2017.[85] The payment will continue to rise until it reaches $207 million by fiscal year 2039.[86]

Mr. Clarkin and Mr. Sasse also testified that the mounting deficit and pension costs will out-pace income from the City's tax levy. Pursuant to State law, the maximum permitted annual levy increase is 4%.[87] Using fiscal year 2014 as an example, Mr. Sasse testified that while the City's tax levy will increase by about $13 million, the City's projected budget deficit

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[79] Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, p. 19.
[80] The Financial Impact Presentation is attached hereto as Exhibit 10.
[81] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 2; Exhibit 10, Financial Impact Presentation, pp. 2, 4.
[82] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 2; Exhibit 10, Financial Impact Presentation, p. 6.
[83] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 2; Exhibit 10, Financial Impact Presentation, p. 6.
[84] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 2–3; Exhibit 10, Financial Impact Presentation, p. 6.
[85] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 2–3; Exhibit 10, Financial Impact Presentation, pp. 7–8.
[86] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 2–3; Exhibit 10, Financial Impact Presentation, p. 7.
[87] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 3; Exhibit 10, Financial Impact Presentation, p. 8; see also G.L. § 44-5-2.

will increase to over $50 million.[88] This means that "the maximum tax increase would be less than a third of what would be needed to close the structural deficit."[89] According to their figures, the increase in the pension ARC alone would consume almost 25% of the increased tax levy, leaving only about 75% to fund other services.[90] By 2016, the pension ARC would account for over 10% of the City's total budget.[91] Mr. Sasse testified that these figures together "point out the unsustainability" of the City's current financial course.[92]

Because of the limitations on additional tax revenue, Mr. Sasse noted that the increase in pension ARC payments would essentially "[crowd] out" the City's ability to fund other public services. For example, Mr. Sasse stated that with so much of the City's additional tax levy going to pay for increased pension costs together with the City's inability to rein in its deficit, the City would be unable to invest in school improvements or purchase new equipment for the police and fire departments.[93] Mr. Sasse testified that simply raising taxes year after year while not being able to invest in infrastructure to increase quality of life would result in the City being unable to attract new businesses and families to grow the City.[94] Such a situation is "unaffordable and unsustainable."[95]

Mr. Clarkin and Mr. Sasse noted that the above-referenced figures assumed an 8.25% rate of return on investments of the assets in the pension plan. If the rate of return were lower, the costs of the pension program relative to the budget deficit and maximum tax levy would increase even more.[96] As will be discussed below in the March 13, 2012 hearing summary, the City's actuaries are performing a study to adjust the assumed rate of return, which will likely be adjusted downward.[97]

Mr. Clarkin and Mr. Sasse also provided an analysis of the impact of the increased pension costs on individual taxpayers of the City, including homeowners and businesses. Mr. Clarkin's first example was an owner of a home valued at $200,000.[98] Currently, the homeowner is paying $3,188 in property taxes.[99] With annual maximum tax increases of 4% per year, the tax payment would rise to $4,719 by 2022, with the taxpayer paying a total of

[88] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 4; Exhibit 10, Financial Impact Presentation, pp. 6, 8.
[89] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 4.
[90] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 4; Exhibit 10, Financial Impact Presentation, p. 8.
[91] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 4; Exhibit 10, Financial Impact Presentation, p. 9.
[92] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 4.
[93] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 4.
[94] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 4.
[95] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 4.
[96] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 4–5; compare Exhibit 10, Financial Impact Presentation, pp. 6–9 with pp. 10–12.
[97] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 12; see also Exhibit 12, Changes to Discount Rate Report.
[98] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 6–7; Exhibit 10, Financial Impact Presentation, p. 13.
[99] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 6–7; Exhibit 10, Financial Impact Presentation, p. 13.

$7,926 in additional taxes over the ten-year period.[100] Of this total, $2,146 of the additional taxes would go to funding the annual increase in pension ARC payments alone.[101]

Mr. Clarkin used local businesses to provide additional examples. One local retail business has an annual property tax bill of $14,005.[102] With annual tax increases at the maximum of 4%, the tax bill would rise to $20,731 by 2022, representing a total additional tax cost of $34,821 over the ten-year period, with $9,432 of this total funding only the annual increase in pension ARC payments.[103] Mr. Clarkin also used a local manufacturing business as an example, which has a total current property tax bill of $132,076.[104] Over a ten-year period of 4% tax increases between now and 2022, the business's tax bill would rise to almost $200,000 per year and the business would pay a total of $328,387 in additional property taxes.[105] Of that total, $88,897 would fund the annual increase in pension ARC payments alone, which is driven mainly by COLAs.[106]

All together, the annual 4% tax increases would significantly outpace inflation. Mr. Sasse testified that the annual tax increases amount to a 48% total tax increase for City residents and businesses over the ten-year period.[107] During that same period, the inflation rate is projected to be between 25 and 30%.[108] At this projected rate, the annual tax increases would outpace economic growth but would still not even pay for half of the City's projected budget deficit.[109] With tax increases at this rate, the City will not be in a position to attract new businesses. Mr. Sasse said that a company with options for its location "is not going to look at Providence" and instead will locate itself somewhere else.[110]

Mr. Sasse and Mr. Clarkin also explained that the effect of a failure of the City to act would be felt throughout the State. Mr. Sasse noted that "[t]he economic health of the State is tied to the economic development of the City. The knowledge district ... the hospitals ... and institutions here are really the economic drivers of the State."[111] If the City stays on its current track, businesses will not be able to "afford to locate here" and the State would lose the ability to attract businesses and jobs.[112]

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[100] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 6–7; Exhibit 10, Financial Impact Presentation, pp. 13–14.
[101] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 6–7; Exhibit 10, Financial Impact Presentation, p. 14.
[102] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 7–8; Exhibit 10, Financial Impact Presentation, p. 15.
[103] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 7–8; Exhibit 10, Financial Impact Presentation, pp. 15–16.
[104] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 7–8; Exhibit 10, Financial Impact Presentation, pp. 17–18.
[105] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 7–8; Exhibit 10, Financial Impact Presentation, pp. 17–18.
[106] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 7–8; Exhibit 10, Financial Impact Presentation, p. 18.
[107] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 8.
[108] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 8.
[109] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 8; Exhibit 10, Financial Impact Presentation, p. 6.
[110] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 9.
[111] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 10.
[112] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 10.

In conclusion, Mr. Sasse testified that much of what is driving these deficit and tax increases is the mounting cost of the City's pension plan. The increase in pension ARC payments is "a key contributor to the economic spiraling-down for the entire City."[113] Indeed, one of the "major drivers" of the increase in the structural deficit comes from "the cost of the COLAs."[114] Mr. Sasse advised that the Mayor's proposals relative to the suspension of COLA's are "critical to avoid the economic crisis" facing the City.[115] According to Mr. Sasse, if the City is to "get this structural deficit under control, [the City must] deal with the pension issues."[116]

**March 13, 2012 Hearing**

On March 13, 2012, the Subcommittee heard testimony from Ms. Cranna, Mr. Bonanno, and Mr. Zmich of Buck Consultants, the City's actuary. The Subcommittee's summary of their testimony, as accepted by the Subcommittee, is as follows:

Mr. Bonanno began by explaining the work performed by Buck Consultants on behalf of the City. Every year, Buck Consultants performs an evaluation of the pension program and issues a report on its findings. The information reviewed during the evaluation process includes the benefits provided, membership data, assumptions on returns, and the value of assets and payments. From this information, Buck Consultants creates a valuation of the pension system.[117] The representatives testified regarding Buck Consultant's most recent evaluation, which is described in the *Report on the Eighty-Fourth Valuation of the Employees' Retirement System of the City of Providence as of June 30, 2011* ("Pension Valuation Report").[118]

Mr. Bonanno provided the basic valuation figures regarding the status of the City's pension plan based on Buck Consultants' June 30, 2011 report. As of that date, the City had a total pension liability for active and retired employees of approximately $1.3 billion.[119] That liability is funded with only $400 million of assets, leaving a total unfunded liability of approximately $900 million.[120] Based on the City's current amortization plan, the pension plan will not be fully funded for another twenty-eight years.[121]

In response to a question from Chairman Salvatore, Mr. Bonanno emphasized that the City cannot fix its current financial problems by delaying pension ARC payments. The ARC payment consists of the payment towards the unfunded portion of accrued liability, together with the payment for presently accruing pension liability (i.e. funding for current employees). To fund pension liabilities as they accrue and to catch up on the unfunded liability for past accruals within the twenty-eight year period, the City must make 100% of its pension ARC

[113] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 9.
[114] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 11.
[115] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 9.
[116] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 11.
[117] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, pp. 1–3.
[118] The Pension Valuation Report is attached hereto as Exhibit 11.
[119] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, pp. 2–3; Exhibit 11, Pension Valuation Report, p. 1.
[120] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, pp. 2–3; Exhibit 11, Pension Valuation Report, p. 1.
[121] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 3.

payments or else it will continue to fall behind in its funding ratio.[122] Forgoing some of the ARC payments in the near term would only extend the term of repayment on the debt. This would, in turn, result in greater costs in the future to catch up for falling further behind in the present. According to Mr. Bonanno, "whatever [the City saves] now is going to cost [it] more in the future."[123] Ms. Cranna confirmed that it would not "be fiscally responsible for the City to even skip one year to meet short term" deficits.[124]

Ms. Cranna pointed out that the City should not forego current payments because the City already is "in a negative cash flow position" with respect to its pension plan. Ms. Cranna testified that the City "is paying out more in benefits every year than [the City is] putting into the system."[125] This means that the City currently is "taking existing assets out to pay benefits."[126] Although the assets being used to pay current benefits are only partially replenished by the ARC payment, over time, with the annual increase of the amount of the ARC payment, the contributions and return on investments will catch up to the amount of benefits being paid out. If the City does not make its ARC payments, however, the unfunded portion will continue to grow and the City will have difficulty closing the funding gap.[127]

Mr. Bonanno also explained that, between active employees and current retirees, the retirees make up the majority of the total pension liability. Current retirees, Mr. Bonnano noted, account for $950 million, or about 72% of the $1.3 billion in total pension liability (funded and unfunded).[128] Liability for the pensions of active employees accounts for only about 28% of the total pension liability.[129] Because the retiree liability accounts for the vast majority of the total pension liability, any effective cost saving measures must "focus [on] the retiree side" in addition to the active employee side of the system.[130]

According to Mr. Bonanno and Ms. Cranna, within the retiree liability, reforming COLA costs is the most effective way to save on pension costs. Mr. Bonanno pointed out that there are only two cost contributors to examine when looking to save on retiree pension liability: benefits and COLAs. To avoid reducing pension benefit payments, Mr. Bonnano said that the City must consider adjusting COLAs along with other pension reform measures. Because many of the City's pensions are compounding at rates ranging from as high as 3% to 6%, Ms. Cranna explained that suspension of COLAs will produce the most efficient savings for the City's pension system.[131] Put simply, Mr. Bonanno said that the City should adjust COLAs because "that is the biggest piece of the pie."[132]

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[122] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, pp. 3–4.
[123] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 4.
[124] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 4.
[125] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 4.
[126] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 4.
[127] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, pp. 5–6.
[128] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 7.
[129] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 7.
[130] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 7.
[131] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 7.
[132] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 7.

Mr. Bonanno also discussed the potential savings that could be realized from a suspension of COLAs. The estimates performed by Buck Consultants indicated that, if the City suspended COLAs for future years, the City would immediately realize a reduction in unfunded liability of approximately $250 million.[133] Because the unfunded liability would drop, Mr. Bonnano said that the ARC payment also would drop by over $16 million this year alone.[134] The City also would realize a greater reduction in each of the ARC payments for subsequent years.[135]

In response to a question by Councilwoman Matos, Mr. Bonnano discussed the impact of a lower-than-expected rate of return on the City's pension investments. The City's recent pension valuations have been based on an assumed rate of return of 8.25%.[136] Because the ARC payment is based on the assumed rate of return, an actual return at a lower rate will cause fewer assets to be put into the pension system.[137] This causes an increase of the unfunded portion of the pension liability.[138] To account for variances between actual and assumed returns, the assumed rate is adjusted periodically, following an analysis of past and expected future performance.[139] Buck Consultants is currently in the process of performing a study of the assumed rate and likely will adjust it to a lower rate in the near future.[140] A downward adjustment of the assumed rate will "result in higher [unfunded] liabilities and higher ARCs as well" because "[w]hen the investment rate goes [down,] liabilities always go up."[141]

Toward the end of the hearing, the Subcommittee received additional exhibits from Buck Consultants, which contained findings discussed during the hearing:[142] A February 23, 2012 Report from Buck consultants, *Alternative Changes to Discount Rate* ("Changes to Discount Rate Report");[143] and A February 23, 2012 Report from Buck Consultants, *Pension Change Scenarios for Providence City Council* ("Pension Change Scenarios Report").[144]

The Subcommittee requested an additional report from Buck Consultants regarding several possible permutations of COLA suspensions.[145] Buck Consultants has since submitted two reports in response to the Subcommittee's requests: (1) March 27, 2012 Report from Buck Consultants, *Additional Proposed Changes to COLAs*, ("March 27 COLA Analysis")[146]; and (2) March 28, 2012 Report from Buck Consultants, *Additional Proposed Changes to COLAs*, ("March 28 COLA Analysis").[147]

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[133] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 15.
[134] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 15.
[135] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 15.
[136] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 10.
[137] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 10.
[138] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, pp. 10–11.
[139] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, pp. 10–11.
[140] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 12.
[141] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 12.
[142] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, pp. 20, 24.
[143] The Changes to Discount Rate Report is attached hereto as Exhibit 12.
[144] The Pension Change Scenarios Report is attached hereto as Exhibit 13.
[145] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, pp. 21–24.
[146] The Mar. 27 COLA Analysis is attached hereto as Exhibit 17.
[147] The Mar. 28 COLA Analysis is attached hereto as Exhibit 18.

**March 20, 2012 Hearing**

On March 20, 2012, the Subcommittee entered into the record (1) the City's Independent Accountant's Report; (2) five letters ("Subcommittee Letters Regarding March 20, 2012 Hearing") from the Chairman of this Subcommittee to Mr. Donald Iannazzi, to the president of the Fraternal Order of Police (the "FOP"), to the president of Local 799 Firefighters, to the president of the Retired Police and Firefighter's Association, and to attorney Joseph Penza, inviting these parties to attend the March 20, 2012 hearing to discuss the Subcommittee's ongoing efforts to reform the City's retirement system; and (3) the response of the president of the FOP to the Subcommittee Letters Regarding March 20, 2012 Hearing (the "FOP Response").[148] The Subcommittee read the FOP Response into the record. The FOP Response pointed this Subcommittee to the negotiations between the City and the FOP from last year, which, according to the FOP, "contained several provisions instituting substantial financial reforms with respect to Pension Benefits received by members of the FOP."[149]

In addition to admitting the exhibits referenced above, the Subcommittee also heard testimony from Donald Iannazzi, Robert Jarvis (president of the Retired Police and Firefighters Association) and attorney Joseph Penza at this hearing. The summary of their testimony, as accepted by the Subcommittee, is as follows:

Mr. Iannazzi is the business manager and chief executive officer of Public Employee's Local Union 1033 ("Local 1033"), representing approximately 2,000 active members of the City's retirement system, the majority of whom are Class A employees, and approximately 3,000 beneficiary retirees of the City.[150] Mr. Iannazzi testified that Local 1033 is prepared to "reform this pension system and bring about the type of substantial changes that are needed to get through the next five decades. If this council doesn't have that credibility and doesn't have that sincerity, then I ask you to get out of the way and allow Class A's to join the MERS system and to support that effort."[151] According to Mr. Iannazzi, Local 1033 had been seeking a meeting on pension reform with the City since April 2011.[152] Councilman Zurier later commented that it seems premature to have a discussion with the unions "until we know the whole scope of the problem so that there are not further agreements that prove to be obsolete later on."[153]

Mr. Iannazzi outlined Local 1033's previous efforts "to reduce the future accrual of benefits for Class 'A' members," mentioning that, through the late 1990s and early 2000s, the union "testif[ied] against every city budget because the city wasn't funding the pension system."[154] He further testified that Local 1033 now "recognizes the taxpayer can afford no

[148] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, pp. 1–2. See also Exhibit 14, Independent Accountants' Report; Exhibit 15, Subcommittee Letters Regarding Mar. 20, 2012 Hearing; Exhibit 16, FOP Response.
[149] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, pp. 1–2. See also Exhibit 16, FOP Response.
[150] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 2.
[151] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 2.
[152] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 3.
[153] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 8.
[154] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 3.

more" but noted that the union had "done its business honorably with the city and the city hasn't responded in-kind."[155] Nevertheless, Mr. Iannazzi said that he is willing to "look at how we can correct the system."[156] Mr. Iannazzi testified that he seeks a system "that is partitioned, so that the sacrifices and the changes that are made by the Class 'A' memberships benefits the city, the taxpayer and the Class 'A' member."[157]

Next, Mr. Iannazzi provided his comments on the proposed pension changes "that [are] on the table," which were as follows:

- That there are changes in the proposal that affect employees with less than 10 years, when "this council established the vesting privilege at 5 years;"
- That Local 1033 is willing "to contribute more than the current 8 percent...when there is an ability to do that," but Local 1033 cannot afford to immediately increase contributions because the union "just reduced...take home pay by 2 percent." Mr. Iannazzi suggested a "benefit akin to a single payment annuity so that on every fifth anniversary the annuity portion of our benefit would go up;" and
- That the section of the proposals on disability pensions be deleted entirely, so that this part of the retirement will be utilized to purchase a "long term disability insurance benefit for all city workers" that terminates at the age of normal retirement, and then the retirees will "receive a service pension based upon the years of service which would include the years that they received a long term disability benefit."[158]

Mr. Iannazzi also testified that he has appointed two pension review committees: one committee focusing on retirees and another for active employees.[159]

Mr. Iannazzi concluded that "the retirement system has failed because nobody, including me, has accepted 100 percent of the responsibility that comes with our fiduciary positions. And that we have all wrongfully assumed that the retirement system will last forever and a day. We have tried to fix it in the past. We need to fix it now or recognize that we are incapable of fixing it and allow us to join the MERS system."[160]

After Mr. Iannazzi's conclusion, Chairman Salvatore also asked Mr. Iannazzi whether he believes that the five and six percent COLAs are sustainable.[161] Mr. Iannazzi responded that they are not sustainable, and he is "prepared to sign a modification to the consent decree."[162] However, he will not "tread on the rights of Class 'B' members and Class 'B' retirees...So part of the solution is a partition of the Employee's Retirement System, and that corpus that belongs to the Class 'A' members will fund Class 'A' benefits."[163]

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[155] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 4.
[156] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 4.
[157] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 5.
[158] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, pp. 5–7.
[159] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, pp. 8–9.
[160] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 7.
[161] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 9.
[162] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 9.
[163] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 9.

Next, Mr. Jarvis, president of the Retired Police and Firefighter's Association (the "Association"), which represents approximately 1200 members and their widows, testified.[164] Mr. Jarvis testified that the Association is willing to "be part of the solution" and to "sit down and talk, but we need information, we need facts and figures."[165] He also noted that when the City decided to transfer certain retirees to Medicare, "there was no discussion, there was no call, just a letter arrived in the mail the Friday after Thanksgiving and I had people panicking."[166]

After Mr. Jarvis's statement, Chairman Salvatore similarly asked Mr. Jarvis whether he believes that the five and six percent COLAs are sustainable.[167] Mr. Jarvis answered that COLAs at five and six percent are not sustainable and that there should be some sort of modification.[168] However, Mr. Jarvis indicated that "suspending them for 20 years would be taking COLA's away from their entire lives."[169] He noted that police and firefighters do not receive social security benefits.[170] Mr. Jarvis remarked that "[y]ou keep hearing about that single individual who makes very, very high numbers...well the median income of the retirees is $40,000. We are not seeing the full picture."[171]

Lastly, Mr. Penza, attorney for the Association, testified.[172] He first stated that Mr. Jarvis's reluctance to set forth his positions was based on ongoing discussions between the Association and the City involving both Medicare and COLA issues.[173] Next, Mr. Penza noted that there is a potential for savings with a system in which individuals receive disability pension until the normal date of retirement and then switch to a service retirement pension."[174]

Regarding COLAs, Mr. Penza testified that most retirees after serving for 20 years "retire, not to go fishing, not to play golf, but they get another job. When I asked them if they could do without COLA for a bit of time, they all said yes, as long as they planned for it."[175] Mr. Penza emphasized that the current retirees he represents, who are in the "$40,000 [per year] range," and "don't have the ability to earn anymore income," planned their retirement "based on what they anticipated receiving" and now "to have that suddenly pulled from them is rather dramatic."[176] Mr. Penza also noted that the Association was the last group engaged by the City in its negotiations to address the deficit.[177]

[164] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 10.
[165] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 10.
[166] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 10.
[167] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, pp. 10–11.
[168] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 11.
[169] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 11.
[170] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 11.
[171] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 11.
[172] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 11.
[173] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 11.
[174] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 11.
[175] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, pp. 10–11.
[176] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 12.
[177] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 12.

Like Mr. Iannazzi and Mr. Jarvis, Mr. Penza testified that the current pension system cannot sustain a five percent or six percent COLA, and the Association is prepared to address that lack of sustainability in negotiations with the City.[178]

Councilwoman Matos asked Mr. Penza what he had heard from retirees with pensions of $30,000 to $40,000 regarding what they would do if the City files for bankruptcy.[179] Mr. Penza responded that they are scared and, as a result, "come to the table."[180] Chairman Salvatore reiterated that the concern is that, in bankruptcy, retirees with pensions of $30,000 might be reduced to as low as $10,000 to $15,000.[181] Mr. Penza noted that some members of the Association are already only "making $12 to $15 thousand dollars a year."[182]

Prior to the conclusion of the March 20, 2012 hearing, Mr. Iannazzi noted that Class "A" retirees that retired before 1969 average $3,800 in annual benefits while the mean benefit for Class "A" members from 1969 going forward is $24,200.[183]

[178] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, pp. 12–13.
[179] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 13.
[180] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 13.
[181] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 14.
[182] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 14.
[183] Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 15.

# FINDINGS AND CONCLUSIONS

## Status of the Pension System and the City's Fiscal Health

The City's current financial situation is, by all accounts, dire and the severity of the crisis cannot be overstated. The City is facing massive and growing structural budget deficits that are destroying the City's cash flow. The structural budget deficit for the current year is projected to be between $23 and 30 million.[184] The City's structural budget deficit is expected to continue to increase over the next several years to over $67 million by fiscal year 2017.[185] Whether the City can continue down this path and function until that time is, however, in serious doubt. The massive deficits plaguing the City will clearly deplete the City's funds at some point in the near term. Without the funds to operate, the City will not be able to operate or make ARC payments to the pension system.

More specifically, the City's pension system is severely underfunded and its mounting costs are contributing significantly to the City's structural deficit and cash shortage. According to recent actuarial assessments, the City's pension plan is currently funded at only approximately 34%.[186] Currently, the City has the largest gap between its actual contributions to date and required funding of any municipality in the State.[187] According to Mr. Almonte, the required funding rate for many businesses is as high as 80%.[188] A minimum-funding ratio commonly used to mark relative stability for a government pension plan is about 70%. With the City far short of this mark at only 34%, the Auditor General has labeled the City's pension as one of the "highest risk plans of the whole State."[189]

Over the next twenty-seven years, the City's ARC payments will continue to "increase dramatically" every year until the unfunded liability is fully amortized.[190] The City will not fully fund its pension system until 2039 based on the current amortization schedule.[191] After that point, the City's ARC payments will substantially decrease.[192] Until then, however, the ARC payments will continue to increase each year by approximately 5%, assuming an 8.25% rate of return on investments.[193] If the return is lower, then the City's ARC payments will increase at a greater rate.[194] Based on these projections, the total ARC payment will rise from approximately $55.8 million in fiscal year 2012 to over $207 million in fiscal year 2039.[195]

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[184] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 2.
[185] Exhibit 10, Financial Impact Presentation, p. 6.
[186] Exhibit 6, Review Panel Report, p. 11; Municipal Pensions Report, p. 14, 22, 25
[187] Exhibit 7, Municipal Pensions Report, p. 19.
[188] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 15.
[189] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 15.
[190] Exhibit 6, Review Panel Report, p. 11; Exhibit 10, Financial Impact Presentation, p. 7.
[191] Exhibit 6, Review Panel Report, p. 11.
[192] Exhibit 6, Review Panel Report, p. 11.
[193] Exhibit 6, Review Panel Report, p. 11.
[194] Exhibit 6, Review Panel Report, p. 12.
[195] Exhibit 10, Financial Impact Presentation, p. 7.

Required ARC payments for the pension plan together with OPEB contributions currently equal approximately 51% of the City's total annual tax levy.[196] This ratio is dangerously close to that of Central Falls, a city forced to file for bankruptcy, which has a ratio of ARC payments to annual tax levy of approximately 58%.[197] Indeed, the bankruptcy of Central Falls was "in part, prompted by the near insolvency of its locally-administered pension plans."[198]

Furthermore, one of the reports submitted to the Subcommittee indicated that, unless the City takes measures to stabilize its pension system, the cost to borrow money for capital improvements will only increase. Bond rating agencies have increased their focus on a municipality's ability to manage its pension liabilities.[199] Failure to demonstrate "responsible management" will cause rating agencies to downgrade the risk assessment of municipal bonds.[200] A downgrade will only increase the cost of borrowing additional funds and can even hinder access to capital markets.[201] In fact, the City already has experienced credit rating downgrades attributable, in part, to instability of its pension system.[202]

## Causes of Funding Shortfalls

There are several contributing causes to the underfunding of the pension system. For many years, the City gave generous retirement benefits, including relatively high COLAs, liberal disability increases and early retirement age requirements.[203] In addition, the City also failed to fully fund the pension system by making the required ARC payments.[204] Across the State, a lack of fiscal discipline imposed on municipalities has resulted in cities and towns providing far too generous of benefits without adequate funding. [205] Additionally, with early retirement age requirements and the advances in healthcare, individuals are retiring earlier and living longer than ever before.[206] And the rising costs of health care and increases in life-expectancy have further strained the City's ability to make payments for health care services as they are incurred.[207]

The recent global financial meltdown has eviscerated the City's financial stability.[208] Although the practice of giving generous benefits without fully funding the pension system may have been sustainable in prior years, in light of recent market events, this is no longer the case. The ripple effects created by the financial crises have resulted in significantly lower tax

[196] Exhibit 7, Municipal Pensions Report, pp. 2, 35–36; Exhibit 6, Review Panel Report, p. 13; Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 9–10.
[197] Exhibit 7, Municipal Pensions Report, p. 2; Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 10.
[198] Exhibit 7, Municipal Pensions Report, p. 6.
[199] Exhibit 7, Municipal Pensions Report, p. 1.
[200] Exhibit 7, Municipal Pensions Report, p. 1.
[201] Exhibit 7, Municipal Pensions Report, pp. 1, 7, 17.
[202] Exhibit 7, Municipal Pensions Report, p. 18.
[203] Exhibit 6, Review Panel Report, p. 11; Exhibit 7, Municipal Pensions Report, p. 2, 6, 36.
[204] Exhibit 6, Review Panel Report, p. 11; Exhibit 7, Municipal Pensions Report, p. 2.
[205] Exhibit 7, Municipal Pensions Report, p. 3.
[206] Exhibit 7, Municipal Pensions Report, pp. 6, 39.
[207] Exhibit 7, Municipal Pensions Report, pp. 29–30, 39.
[208] Exhibit 7, Municipal Pensions Report, pp. 1, 38, 39, 41.

revenues.[209] Furthermore, poor market performance for several years has caused the pension system to receive a lower rate of return on its investments, increasing the required ARC payment.[210] Lower income coupled with greater payment obligations have overburdened the City's budget, leading to massive budget deficits.[211]

Furthermore, the global financial crisis has affected the State's financial health, requiring it to dramatically lower aid provided to cities and towns. The substantial reduction in State aid to the City has contributed to the City's financial instability and inability to sustain its pension system.[212]

**The Need to Act to Sustain the Pension System**

The City has no choice but to institute pension reforms to stabilize and improve the financial condition of the City.[213] According to the Review Panel Report, the City must "aggressively pursue pension reform measures to contain the growing annual required pension contributions [and] to improve the status of its pension plan to enhance its overall financial picture."[214] If left unaddressed, the mounting cost of pension system and OPEB liabilities will consume the City's budget, which already is running at a structural deficit.[215] Together, the structural deficit and increasing cost of the pension system will run the City out of cash and force it into bankruptcy.[216]

If the City runs out of funds, it will not be able to provide critical services to its residents, diminishing their quality of life and endangering their health and welfare.[217] A lack of funds means that the City will not be able to pay its employees or its vendors.[218] Without employees and necessary equipment, the City's ability to provide emergency services, including police and fire services, would dramatically decrease or cease altogether, putting the public safety at risk. Without employees, the City would not be able to provide other essential services including maintaining public works or city infrastructure, including public buildings. The City would be forced to close even more schools. Public streets and parks would fall into disrepair. Without decisive and quick action, the City will soon run out of funds and will be forced to shut down normal operations and, ultimately, enter bankruptcy.[219]

Many of the witnesses that testified before the Subcommittee emphatically warned that the City must act on the rising pension and OPEB costs at once to prevent such imminent

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[209] Exhibit 7, Municipal Pensions Report, pp. 1–2, 6, 38–39.
[210] Exhibit 4, Mar. 13, 2012 Draft Transcript, pp. 10–14; Exhibit 12, Changes to Discount Rate Report; Exhibit 7, Municipal Pensions Report, pp. 2, 6, 38–39.
[211] Exhibit 6, Review Panel Report, pp. 11–12; Municipal Pensions Report, pp. 38–39.
[212] Exhibit 7, Municipal Pensions Report, pp. 1, 37, 41.
[213] Exhibit 6, Review Panel Report, p. 11.
[214] Exhibit 6, Review Panel Report, p. 12.
[215] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 12–13.
[216] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 26–27.
[217] Exhibit 7, Municipal Pensions Report, p. 1, 40; Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 26–27.
[218] Exhibit 6, Review Panel Report, p. 14.
[219] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 26–27.

problems. According to Mr. Almonte, the City's pensions problem "is that severe and it has to be tackled now."[220]

**Measures Already Taken by the City to Address its Fiscal Crisis**

The City already has taken numerous difficult, but necessary cost-saving and revenue-generating steps to work towards closing the structural deficit and making the pension system sustainable. Some of these cost-saving measures include: reducing the budget of the Mayor's office, reducing the size of the City's workforce, reducing the budget of the fire and police departments, closing schools, and revising labor contracts with police, fire, education and municipal employees.[221] Some of these revenue-generating measures include: increasing parking fees, enhancing enforcement of parking regulations, increasing dumpster and mattress disposal fees, increasing both residential and commercial property taxes, and increasing the taxable assessment on motor vehicles.[222]

These measures have allowed the City to reduce its budget deficit for this fiscal year from approximately $100 million to somewhere between $23 and 30 million.[223] More measures are needed, however, if the City is to maintain its cash flow and continue operating.

**The Impact of Compounding Cost-of-Living Adjustments**

Current COLAs that compound at rates of up to 6% are consuming a substantial portion of the City's contributions to the pension program and the increased costs are crushing the City's financial stability. Approximately 27% of retirees are currently receiving annual COLAs of 5 to 6%, which compound annually.[224] A pension with a 6% compounding COLA doubles approximately every 12 to 13 years and a pension with a 5% compounding COLA doubles approximately every 16 years.[225]

The current compounding COLAs are one of the major cost drivers of the City's pension system and account for a significant portion of the unfunded liability.[226] For fiscal year 2013, over $16 million of the $64.8 million ARC payment will fund COLAs alone. A low rate of return on investments and relatively high, compounding COLAs results in growth of unfunded liability.[227] High COLA rates eat into the gains from investments, diminishing the contribution provided by investing pension assets.[228] By not having a sufficiently large amount of assets in

[220] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 13.
[221] Compare Exhibit 8, Feb. 7, 2012 Hearing Handout 2, *Shared Sacrifice Checklist*; with Exhibit 6, Review Panel Report, pp. 17–19, 22–23.
[222] Compare Exhibit 8, Feb. 7, 2012 Hearing Handout 2, *Shared Sacrifice Checklist*; with Exhibit 6, Review Panel Report, pp. 17–19, 22–23.
[223] Compare Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 5, with Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 2; Exhibit 5, Mar. 20, 2012 Draft Hearing Transcript, p. 12.
[224] Exhibit 6, Review Panel Report, p. 12; Exhibit 11, Pension Valuation Report, pp. 3, 27.
[225] Exhibit 6, Review Panel Report, p. 11; Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 14.
[226] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 14; Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 11; Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, pp. 7–8.
[227] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 12.
[228] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 12.

the program, together with the compounding COLAs the total cost of the pension system will continue to rise, requiring the City to steadily increase its ARC payments over the next twenty-seven years, when the system is fully funded.[229]

COLA adjustments at this rate "are extraordinarily excessive and are inconsistent with their intent, which in essence was to preserve purchasing power eroded through inflation."[230] At this pace, pensions receiving these COLAs "far outpace amounts paid to active employees who are not receiving annual salary increases that even approximate 5% or 6% annually."[231]

The experts that testified before the Subcommittee consistently warned that suspension of COLAs was a critical and necessary step to preserving the City's pension system. According to one expert that testified, "it will totally consume [the City's] whole budget" if not addressed.[232] Indeed, COLAs were identified as "one of the major drivers of the structural deficit," making COLAs a factor that has to be addressed if the City is "ever going to get this structural deficit under control."[233] Other experts testified that addressing COLAs is the most efficient way to address the City's pension funding difficulties and would result in the "most savings" for the pension system.[234]

Suspending COLAs until the pension system reaches a funding ratio of 70%[235] would result in significant and desperately needed cost savings for the pension system. This measure would immediately increase the City's pension funding ratio from 31.94% (as of June 30, 2012) to almost 40%.[236] The amount of the unfunded pension liability would decrease by over $240 million, from $901 million down to $659 million.[237] With these cost savings, the City is projected to fund 100% of its pension system ahead of the current amortization schedule.[238] The City's fiscal year 2013 pension ARC payment would decrease over $16 million, from $64.8 million down to $48 million.[239] Moreover, these savings in the ARC payment would repeat (and, in fact, grow) each year until the pension system is fully funded. These immediate savings are critical to closing the City's structural deficit so that the City can continue to make its pension ARC payments and work towards fully funding the pension system.[240]

## The Impact of Other Measures Recommended by the Witnesses Before the Committee

### Adjustments to Pension Contribution Rates and Benefit Calculations

[229] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 12.
[230] Exhibit 6, Review Panel Report, p. 12.
[231] Exhibit 6, Review Panel Report, p. 12.
[232] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 12–13.
[233] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 11.
[234] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 7.
[235] According to estimates by Buck Consultants, the pension system will reach a 70% funding level in 2036. Exhibit 18, March 28 COLA Analysis, pp. 1–2 & attachment.
[236] Exhibit 18, Mar. 28 COLA Analysis, p. 1.
[237] Exhibit 18, Mar. 28 COLA Analysis, pp. 1–2 & attachment.
[238] Exhibit 18, Mar. 28 COLA Analysis, pp. 1–2 & attachment.
[239] Exhibit 18, Mar. 28 COLA Analysis, pp. 1–2 & attachment.
[240] Exhibit 18, Mar. 28 COLA Analysis, pp. 1–2 & attachment.

Among the recommendations made by the witnesses and reports given to the Subcommittee were adjusting the amount of pension contributions and the method by which pension benefits are calculated.[241] One of the measures under consideration involves extending the length of time a pension member will contribute to towards their pension.[242] By extending contributions, the City could avoid an immediate increase in the required rate of contribution and still reduce the ARC payment by approximately $1.69 million of the fiscal year 2013.[243] In addition, adjusting the calculation of the pension benefit from the highest three years of compensation to the highest five years of compensation of a retiree's final ten years of employment would result in savings of $1.25 million in fiscal year 2013, with a total reduction in unfunded pension liability of over $10 million.[244]

Adjustments to Disability Pension Benefits

Among the challenges to be addressed in reforming the disability pension system are the substantial costs of the benefit amounts provided relative to salaries of active employees and retirement pension benefits.[245] An analysis by Buck Consultants, the City's actuary, indicated that reducing the benefit for active participants from 66⅔% to 50% of final compensation (but not less than the service retirement allowance) would result in savings of almost $500,000 in fiscal year 2013 and would reduce the unfunded accrued pension liability by approximately $1.5 million.[246] Such savings are crucial to bringing the disability pension system benefits to an affordable and sustainable level for the City.[247]

Adjustments to OPEB Costs

The current costs of the City's retiree medical benefits and the cost of the unfunded OPEB liability are crushing the City's finances and the City simply cannot sustain its OPEB plans as they exist today. Currently, the City has funded less than 1% of its total OPEB liability of approximately $1.5 Billion.[248] Rather than paying for benefits from a built up fund for OPEB liabilities, the City has used a "pay-as-you-go system" whereby the City pays for retiree medical costs as they are incurred. These payments, together with medical costs for current employees are consuming approximately 15% of the City's total annual budget.[249] With the constantly rising costs of health care and increased life expectancy, the unfunded OPEB liability will continue to grow, requiring payments for medical expenses that the City simply cannot afford to make in its current financial situation.[250]

[241] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 6–7, 12, 22–24; Exhibit 6, Review Panel Report, pp. 12–13; Exhibit 7, Municipal Pensions Report, p. 42.
[242] Exhibit 13, Pension Change Scenarios Report, p. 2.
[243] Exhibit 13, Pension Change Scenarios Report, p. 2 & attachment.
[244] Exhibit 13, Pension Change Scenarios Report, p. 1 & attachment.
[245] Exhibit 6, Review Panel Report, pp. 12–14; Exhibit 2, Feb. 14, 2012 Draft Hearing Transcript, pp. 3–4.
[246] Exhibit 13, Pension Change Scenarios Report, p. 2 & attachment.
[247] Exhibit 6, Review Panel Report, pp. 12–14.
[248] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 6; Exhibit 6, Review Panel Report, pp. 2, 15.
[249] Exhibit 6, Review Panel Report, pp. 2, 14–15.
[250] Exhibit 7, Municipal Pensions Report, pp. 30, 39.

To alleviate these costs, the evidence before the Subcommittee includes recommendations that the City align its benefit provisions with those benefits provided by the State, which require plan members to make standard co-pays of 20% until that member joins the Medicare system.[251] Doing so would result in significant and necessary cost savings to the City by reducing current and future OPEB costs.[252]

Procedures for Determining Assumed Rates of Return

Finally, shortfalls in the assumed rate of return on pension investments have contributed significantly to the underfunding of the pension system.[253] When the City earns a rate of return that is lower than the assumed rate, the unfunded liability of the pension system rises because the City is contributing less to the system on the assumption that more money is being earned from its investments.[254] To correct the gap created by shortfalls in assumed returns, the City should adopt new procedures to evaluate and adjust its assumed rate of return with sufficient regularity to keep it consistent with actual performance.[255]

**Other Options Considered for Resolving the Fiscal Crisis & Sustaining the Pension System**

The City cannot avoid making ARC payments in the short term to address its fiscal crisis. To sustain its pension system, the City must make 100% of its ARC payments.[256] Contributing at the required level "is key to eventually reducing unfunded liabilities."[257] Failing to fully fund ARC payments will only push the current costs of the pension system to future generations, at an increased cost.[258] The consequences of increased costs and prolonged uncertainty associated with chronic underfunding of the pension system would outweigh any short-term gains realized by the City.[259] The Government Finance Officers Association ("GFOA") has issued the following recommendation and warning regarding the failure to fully fund pension systems:

> The GFOA recommends that under no circumstance should state and local government plan sponsors engage in pension contribution holidays or make insufficient contributions. When employers skip an actuarially required contribution or make a smaller payment than required, they defer that cost to the future and jeopardize the long-term funding of the plan. When governing bodies arbitrarily reduce contributions to a plan, the resulting systemic underfunding ensures future financial shortfalls and places the burden of that

[251] Exhibit 6, Review Panel Report, pp. 15, 17; Exhibit 7, Municipal Pensions Report, pp. 30, 39.
[252] Exhibit 6, Review Panel Report, pp. 14– 17; Exhibit 7, Municipal Pensions Report, pp. 30, 39.
[253] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 10–12; Exhibit 7, Municipal Pensions Report, p. 26.
[254] Exhibit 4, Mar. 13, 2012 Draft Hearing Transcript, p. 10–12; Exhibit 6, Review Panel Report, p. 12; ; Exhibit 7, Municipal Pensions Report, p. 26.
[255] Exhibit 6, Review Panel Report, pp. 12, 14; Exhibit 7, Municipal Pensions Report, p. 26.
[256] Exhibit 6, Review Panel Report, p. 11; Exhibit 7, Municipal Pensions Report, p. 3, 41; Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 9.
[257] Exhibit 7, Municipal Pensions Report, pp. 1, 3, 23.
[258] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 16–17.
[259] Exhibit 7, Municipal Pensions Report, pp. 1, 6, 7, 40.

> shortfall on future taxpayers. These types of funding decisions compound future funding problems and are, in many instances, a leading cause of funding shortfalls.[260]

In sum, suspending payments to save money today while "passing ... our debt" on to "our children and grandchildren" is an unacceptable and unsustainable way to address the City's pension crisis.[261]

The City cannot solve its financial problems by simply borrowing to meet current liabilities. Deferring payment on the pension liability into the future will only create more difficult financial problems as the City attempts to meet its future obligations, as well as those of the past.[262] Borrowing is typically useful to pay for one-time capital expenditures but is not a reasonable or sustainable solution to solving a recurring structural budget deficit.[263] Pushing current costs into the future will only make the City's financial situation worse.[264]

Re-amortization of the unfunded liability also will not solve the problems facing the City. Similar to borrowing, re-amortization will only push the repayment of the unfunded liabilities into the future, which will result in paying more for the pension obligations over time.[265]

Merging with MERS will not erase the unfunded liability of the City's pension system. Joining MERS may provide better discipline for meeting funding requirements and greater diversification of investments.[266] Because contribution rates for each participating entity are established separately, however, the City still will be required to fully fund its pension system on its own.[267] Furthermore, Mr. Almonte recommended that the City work to address its pension issues, including suspending COLAs and adjusting contributions and benefit levels prior to joining MERS so that the City enters with a more stable and sustainable pension program.[268] Thus, although merging with MERS may prospectively help maintain pension ARC payments, it will not solve the problems associated with the already accrued unfunded liability and its impact on the structural deficit.

The City cannot rely on increased tax revenues to solve its problems. With the cap on annual property tax increases generally at 4%, the increased costs of the mounting deficit and

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[260] Exhibit 7, Municipal Pensions Report, p. 7, quoting the GFOA October 2010 Advisory, *Responsible Management and Design Practices for Define Benefit Pension Plans*. Note: the GFOA Advisory is not attached to this report.
[261] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 16–17; Exhibit 7, Municipal Pensions Report, pp. 6, 7.
[262] Exhibit 7, Municipal Pensions Report, p. 6.
[263] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 26.
[264] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 26–27.
[265] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 16.
[266] Exhibit 7, Municipal Pensions Report, p. 26; Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, pp. 21–22.
[267] Exhibit 7, Municipal Pensions Report, p. 44; Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 21.
[268] Exhibit 1, Feb. 7, 2012 Draft Hearing Transcript, p. 21.

the pension system will out-pace any potential tax growth for the City.[269] A 4% increase in property taxes results in an annual increase of approximately $13 to $15 million per year over the next five years.[270] During that same time period, the budget deficit is projected to increase to over $67 million.[271] Moreover, the annual 5% increase in the ARC payment alone will consume approximately 25% of additional tax revenues, leaving only the remaining 75% for other services and diluting the impact of the tax increase.[272]

Simply raising taxes to the maximum permitted to solve the fiscal crisis also would result in an unsustainably high burden on the City's residents and businesses. If the City were to raise taxes by the maximum allowed every year for the next ten years, a taxpayer's total property tax bill would increase by approximately 48%.[273] Such a high rate will deter new residents and businesses from moving to the City and will drive current residents out.[274] Raising taxes to the maximum amount permitted will only add to the City's problems, not solve them.

[269] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, pp. 3–5; Exhibit 10, Financial Impact Presentation, pp. 6, 8–9.
[270] Exhibit 10, Financial Impact Presentation, p. 8.
[271] Exhibit 10, Financial Impact Presentation, p. 6.
[272] Exhibit 10, Financial Impact Presentation, p. 8.
[273] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 8.
[274] Exhibit 3, Mar. 6, 2012 Draft Hearing Transcript, p. 8.

# RECOMMENDATIONS

The City must close the remainder of its structural deficit or it will run out of funds and ultimately be forced to initiate a shutdown of essential city services and enter bankruptcy. The City also must continue to fund its pension system at sustainable levels in order to best protect the interests of the City's active and retired employees and the community at large. Unfortunately, however, the City cannot do both in its current financial condition.

For the City to continue to function for the benefit of its residents and to sustain its pension system for current and future retirees and employees, the City must realize both immediate savings to close its budget deficit and long term savings to ensure that the ARC payments remain reasonable and affordable to the City. To assist in closing the budget deficit so that the City may continue to make required contributions to fund the underlying pensions, the Subcommittee recommends that the Council take the following steps:

## Recommendation No. 1

The Subcommittee first recommends that the City Council prospectively suspend COLAs on all pensions. The Subcommittee further recommends that the suspension ordinance require the City to use the savings generated to help close the City's structural deficit so that the City may continue to operate and make future pension ARC payments. The Subcommittee recommends that the City continue the suspension until such time as the pension system reaches a funding ratio of 70%. In addition, the Subcommittee recommends that the City Council pass a Resolution authorizing the City Solicitor to commence legal proceedings to modify the Consent Decree entered in the matter of *City of Providence, et al v. The Employee Retirement Board of Providence, et al*, Providence Superior Court C.A. No. 90-2110 (1991), to bring the benefits provided to retirees who retired prior to its effective date in line with those to be provided pursuant to the proposed suspension ordinance.

## Recommendation No. 2

The Subcommittee recommends that the Council require that contributions from all pension system members to continue beyond the current requirement of 25 years of service and, instead, continue as long as members continue to accrue pension credits.

## Recommendation No. 3

The Subcommittee recommends that the Council adjust the base pension benefit to an average of the highest 5 consecutive years of earnings during the final 10 years of a member's employment, a change from the current practice of setting benefits on the basis of a retirees highest three years of earnings.

## Recommendation No. 4

The Subcommittee recommends that the Council adjust current benefits for accidental disability pensions for all active participants from 66⅔% of the participant's final compensation to 50% of the participant's final compensation. In no event, however, shall the benefit be less than the participant's service retirement allowance.

The Subcommittee will issue additional recommendations for disability pension reforms to address the control measures discussed above, after further analysis.

**Recommendation No. 5**

The Subcommittee recommends that the Council place a dollar cap on pension benefits at a level not to exceed one and one-half times the state's median household income.

**Recommendation No. 6**

The Subcommittee recommends that the Council require all retirees and their spouses who receive health care benefits to pay a 20% co-pay of all health care costs until retirees and their spouses reach the age of 65 to bring the City's OPEB plan more in line with those benefits provided by the State.

**Recommendation No. 7**

Finally, the Subcommittee recommends that the Council adopt, by ordinance, a formal process for considering and accepting an assumed rate of return on pension investments to allow the City to more accurately determine its required pension contribution payments.

**Summary of Recommendations and Estimated Savings**

| SUBCOMMITTEE ON PENSION SUSTAINABILITY RECOMMENDATIONS | FY13 ARC SAVINGS* | REDUCTION IN UNFUNDED LIABILITY* |
|---|---|---|
| **Recommendation 1:** Suspend Guaranteed Annual Raises (COLAs) until Pension Plan is Funded 70 Percent | $15.6 million | $236.1 million |
| **Recommendation 2:** Require Employees to Contribute to Pension System so long as Member is Accruing Pension Credit | $1.5 million | Increases Liability $1 million |
| **Recommendation 3:** Adjust Base Pension Benefit to an Average of the Highest Five Consecutive Years during Employee's Final 10 Years of Services | $1.3 million | $10.3 million |
| **Recommendation 4:** Reduce Benefit for Accidental Disability from 66 2/3 Percent to 50 Percent | $500,000 | $1.4 million |
| **Recommendation 5:** Cap Pension Benefits at one and one-half times state's median household income | — | — |
| **Recommendation 6:** Require Retirees and Spouses Who Receive Health Benefits to Pay 20 Percent Co-Pay | Not applicable to pension savings | Not applicable to pension savings |
| **Recommendation 7:** Adopt Formal Process for Considering and Accepting an Assumed Rate of Return on Pension Investments | Not applicable to pension savings | Not applicable to pension savings |

*Based on correspondence from Buck Consultants to Councilman Salvatore dated April 16, 2012[275]

**Conclusion**

Several of the witnesses before the Subcommittee testified that, without these measures, relying solely on other alternatives would have a relatively insignificant effect on the

[275] **A copy of the correspondence, an April 16, 2012 Report from Buck Consultants entitled *Various Pension Cost Reduction Scenarios letter*, is attached hereto as Exhibit 19.**

City's fiscal health, would prolong the current financial crisis into the future, and would require the City take far more drastic steps, such as the breakdown of city government and its public services, from operating schools to maintaining infrastructure. It further appears to the Subcommittee that these pension reform measures will help to maintain current income levels of pensioners instead of imposing drastic reductions in benefit levels, and therefore better meets the expectations of both active and retired employees.

The Subcommittee is mindful of the importance of a pension to retired and disabled employees. Maintaining a steady and secure level of post-employment income is absolutely critical for individuals receiving a pension and can have a positive effect on the economy as a whole. These measures are necessary to permit the City to protect the health, safety, and welfare of its citizens, to avoid bankruptcy and to continue funding the underlying pensions of retirees. As seen in the case of Central Falls, bankruptcy can result in a devastating reduction in pension payments and is a measure that the City must avert with all available options. These measures will provide the City with additional means to avoid such a catastrophic result.

These measures are, by no means, the only step that the City must take to reform and sustain its pension system. Indeed, as demonstrated by the testimony given before the Subcommittee on February 14 and March 20, 2012, additional controls and procedures are needed to reform and maintain the City's disability pension system. The Subcommittee is actively considering several proposals on this and other pension issues discussed during the hearings and will issue further recommendations regarding pension reform as necessary.