State of Rhode Island
Office of the General Treasurer

James A. Diossa
General Treasurer

April 2, 2024

The Honorable Stephen Casey
Chair, House Committee on Municipal Government and Housing

The Honorable Members of the House Committee on Municipal Government and Housing

RE: *2024-H 7241, An Act Relating to Towns and Cities – Optional Retirement for Members of Police Force and Firefighters*

Chair Casey:

I write with regard to 2024-H 7241. This legislation purports to make four discrete changes to the pension benefits afforded police officers and fire fighters in the Municipal Employees' Retirement System ("MERS"). As proposed, this legislation will:

(1) Amend the final average salary formula from the highest five years of pay to the highest year of pay, directly increasing a member's pension benefit;
(2) Permit members of MERS police and fire units to retire at age 57 if they have at least 20 years of service, thereby reducing the requisite years of service to qualify for retirement;
(3) Increase the rate of benefit accrual (the "multiplier") for active members of MERS police and fire units from 2% to 2.5%, again increasing a member's pension benefit; and
(4) Materially reduce early retirement penalties by limiting the penalty to a 3% annual reduction.

This legislation purports to expand retirement benefits for members of MERS police and fire units. As such, it will have an impact on the funded status of MERS units.

Consistent with Rhode Island law, legislation concerning the pension system should not be approved without the benefit of a pension impact note. *See* R.I. Gen. Laws § 45-21-42.2. (Legislation impacting the pension system "shall *not* be approved by the general assembly unless an explanatory statement or note . . . is appended to the proposed legislation which actuarily calculates . . . the projected twenty (20) year cost of the proposed legislation") (emphasis added). This independent assessment will clarify the impact the proposed legislation will have on both the State budget, and the sustainability of the pension system. The Chair of the House Finance

Committee – with the approval of the Speaker of the House – can request a pension impact note concerning proposed legislation originating in the House of Representatives. *See* R.I. Gen. Laws § 45-21-42.2.

An independent actuarial assessment is *particularly* important in the context of this legislation. The Rhode Island Pension Advisory Working Group assessed the financial impact associated with each of these changes individually. *See* Report of the Pension Advisory Working Group, at 3 (Feb. 2024) ("This Report presents the actuarially determined cost for each individual option. However, the actuarially determined cost of multiple options will have a different impact when combined, depending on how the combination of those options influence the behavior of active and retired members of ERSRI.").

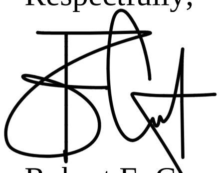
Considered in isolation, the Working Group determined that each of these changes will have a discrete impact on the funded status and long-term sustainability of state-administered municipal pension plans under MERS. That impact varied considerably, from a *de minimis* change to a much larger fiscal impact. But considered together – as they must be for purposes of fully evaluating the impact of this legislation – the interplay between these changes amplifies the impact of any single change. It is therefore improper to say that the cost of change A plus the cost of change B will provide a comprehensive fiscal impact. Rather, change A and change B *together* will have an entirely distinct impact on employee behavior if passed together, which would – in turn – produce an entirely distinct cost figure.

Here, for example, the impact of *increasing* the multiplier from 2.0% to 2.5% will be amplified by amending the final average salary formula to the highest single *year* of pay[1] **–** both of which are used to calculate a member's annual benefit in retirement – while also *decreasing* the retirement age and reducing early retirement penalties, thereby permitting or enticing certain members to collect a pension for several more years than they would be entitled to under prevailing law. The interplay between these changes will have a markedly different impact than the individual changes proposed to and assessed by the Working Group. In order to make a responsible and informed judgment as to the financial feasibility and sustainability of this change, this legislation must have a complete actuarial assessment.

[1] Absent an anti-spiking provision, this change alone could occasion a significant fiscal impact. A salary spike is a strategic increase in late-career compensation intended to increase an employee's retirement income. Salary spiking is problematic for two reasons. "First, salary spiking can result in unfunded liabilities," since an employee's retirement benefit will deviate from expected levels of compensation growth, generally assumed to be constant. Dan Goldhaber, *et al*., *A Method for Identifying Salary Spiking: An Assessment of Pensionable Compensation and Reform in Illinois*, Center for Analysis of Longitudinal Data in Education Research, Working Paper No. 238-0620, at 1 (June 2020). Expected compensation, in turn, drives employer and employee contribution rates during an employee's working life. The costs of unfunded liabilities "are ultimately borne by taxpayers." *Id*. "Second, salary spiking (particularly the most egregious cases) is likely to be viewed by the public as an abuse of the system and inherently unfair." *Id*.

Please feel free to reach out by email at Robert.CravenJr@treasury.ri.gov or by phone at (401) 330-0661 with any further questions.

Respectfully,



Robert E. Craven, Jr.
Director of Legislative Affairs
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cc: The Honorable John G. Edwards