



1998

Report of the Special Commission to Study the Alteration of the Pension System for New Employees

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1998

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Report of

The Special Commission to Study the Alteration

of the

Pension System for *New* Employees

January 1998

Membership:

Robert L. Carl, Jr. Ph.D. Chairman
Mr. Michael DiBiase
Representative Antonio Pires
Senator John Roney
Ms. Marcia Reback
Mr. Joseph Peckham
Mr. Stanley H. Davis
Mr. Robert F. Camiaux
Mr. Kenneth M. Moffat

Department of Administration
Governor's Office
House Finance Committee
Rhode Island Senate
Rhode Island Federation of Teachers
AFSCME – Council 94
Public member, Triangle Wire & Cable
Public member, HASBRO
Public member, Amica Insurance Company



STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

Department of Administration
Robert L. Carl, Jr., Ph.D.
DIRECTOR
One Capitol Hill
Providence, RI 02908-5890

OFFICE (401)277 - 2280
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April 6, 1998

RE: Special Commission to Study the Alteration of the Pension System for
New Employees

To All Interested Parties:

The employees of the State of Rhode Island are an asset to state government and the citizens of Rhode Island whom they serve. As the Director of Administration, one of my responsibilities is to find cost effective means to recruit and retain a high quality work force. The state's pension system is one tool available in this process. Our current pension system has been noted to be expensive to taxpayers and employees, but also is highly valued by career state employees.

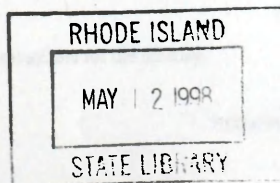
The General Assembly requested in 1995 that an examination be made of the State of Rhode Island's pension system. The recommendations of the study, if adopted, would apply only to *new employees* so that existing employees would not have benefits changed. I was asked to Chair the Commission that had representation from the private sector, labor, and elected officials. The Commission worked hard during the twenty-six meetings held to review the existing system and consider new approaches. They were assisted in their deliberations by an actuarial consultant who provided professional advice on a variety of options considered.

Attached you will find the Report of the Special Commission to study the Alteration of the Pension System for New Employees. In the end the Commission realized that major changes to the system would not yield large savings. On the other hand, it was also found that the current system is significantly different from both private plans and other state plans. While the benefits to career employees are generous, the plan is less attractive to employees who wish to work for the state only during a portion of their career. Given changes in the workforce generally, and the need to attract a diverse workforce, the Commission supported the need to make changes to accommodate these employees. I hope you will find these recommendations useful.

Sincerely,

Robert L. Carl, Jr. Ph.D.
Chairman

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Summary:

This report summarizes the work of the Special Commission to Study the Alteration of the Pension Commission for New Employees. With this report the Commission completes its charge by providing recommendations to the Governor and the General Assembly. The report is based upon a formal record of opinion made at the October 7, 1997 meeting at which seven of the nine members of the Commission were present.¹ It is the intent of this report to briefly discuss the types of issues that confronted the Commission as the members considered modifications to the pension system. As was clear throughout the work of the Commission, this is a complex topic in which the final plan design requires continual evaluation of the actuarial cost or savings to the system. A reference list of the materials reviewed by the Commission is included for more in-depth discussion of specific issues.

Legislative Authority:

The Special Commission to Study the Alteration of the Pension System for New Employees was created by the General Assembly in the 1995 session, the purpose of which:

shall be to study changes to the current state pension system to be applied to new employees, and to report to the Governor and the General Assembly with advice and recommendations as to such changes on or before March 1, 1996²

The Commission was charged with a review of the Employees Retirement System, which encompasses all state employees and the public school teachers within the state of Rhode Island.

Membership:

Robert L. Carl, Jr. Ph D. Chairman	Department of Administration
Mr. Michael DiBiase	Governor's Office
Representative Antonio Pires	House Finance Committee
Senator John Roney	Rhode Island Senate
Ms. Marcia Reback	Rhode Island Federation of Teachers
Mr. Joseph Peckham	AFSCME - Council 94
Mr. Stanley H. Davis	Public member, Triangle Wire & Cable
Mr. Robert F. Carniaux	Public member, HASBRO
Mr. Kenneth M. Moffat	Public member, Amica Insurance Company

Process:

The Commission was convened on October 12, 1995. Research, discussion and deliberation took place over the course of twenty-six meetings. On October 7, 1997 the recommendations were voted on.

The Commission sought to analyze the existing pension system to determine possible changes by soliciting input from actuarial firms familiar with similar pension systems. Letters were sent to six actuarial firms asking them to address the Commission on their

¹ Mr. Davis moved out of state and Mr. Carniaux was ill and therefore unavailable for the meeting.

² RIGL 36-8-21

reaction to a set of questions developed by the Commission³. Four of the firms accepted the offer and addressed the Commission⁴. During these presentations the existing pension system was compared to similar public and private sector plans. Following these briefings, the Commission issued a Request for Proposals to hire a consulting firm to assist in the details of drafting a plan. William M. Mercer, Inc. was selected to perform this service. On June 11, 1996 the details of a proposed plan were developed in a memorandum to the Commission. A Public Hearing was held on January 15, 1997. The Commission voted on the proposed amendments on October 7, 1997⁵.

Background:

The Rhode Island State Pension system was established in 1936⁶ and covers state employees working 20 hours or more per week. In 1949, the system was extended to include public school teachers. Certain differences, notably the member contribution rate, exist between these two groups. Special membership rules also apply to state police, judges, nurses and correctional officers, but these variations were not part of the scope of review. The Commission reviewed the eligibility, contribution and benefit variables for new state employees and new teachers only.

The study suggests that Rhode Island has an excellent pension system with relatively high employee contributions leading to commensurately high benefits when compared to other states. It was also clear that recent legislative reforms and the current professional administration of the pension plan have made a positive impact on the system as a whole insuring greater openness, equity and standardization. Loopholes have been closed and public confidence in the system is being restored. Retirement system members retain positive opinions regarding the system according to the representations by the labor leaders on the panel.

Goals:

The Commission was not charged with a specific set of goals for revisions. Rather the group was asked to look broadly at the existing system and recommend changes. The membership of the Commission reflects a range of interests with sometimes conflicting goals.

Saving money

The Commission was formed at a time when of the retirement system was perceived as costly to both the employees and the state. When compared to other state pension plans the Rhode Island Pension plan provides relatively high member costs and benefits.⁷ The State's contribution for the actuarial cost is low, however, when compared to other states. It is important to also note that the employee contribution rate, 8.75% for state employees and 9.5% for teachers, is higher than most public retirement systems across the country.

³ See attachments for a copy of the letter with the questions asked of the consultants.

⁴ William M. Mercer, Inc.; Michael Peskin Associates, Inc.; The Segal Company; Buck Consultants

⁵ See appendices for a record of the votes.

⁶ RIGL 36-8-1 et seq.

⁷ Foster Higgins, Inc. *Report on State Pension Systems, 1994*.

The system is also somewhat costly in the near term as the State makes payments to address the unfunded liability from the past. The State has been making payments since 1986 to address this liability and is scheduled to continue the payments over a thirty year period. The liability emanated from four contributing factors: the system was created with a liability, the merger of the teacher plan into the state system was not fully funded, the State did not fully fund the annual costs of the plan in some past years, and previous early retirement incentives which have been offered increased the liability.

A defined contribution approach was advocated by Mr. Carniaux of HASBRO for its ability to reduce cost to the employee and the State. Ms. Joanne Flaminio, Executive Director of the retirement system noted, however, that the total cost savings to be achieved would not be as significant as originally envisioned. The creation of a defined contribution system would require the management of two very different systems. This would incur substantial administrative costs and reduced market investment cost savings because of smaller investment pools. Therefore, cost reductions would not occur in the short run. Further, despite potential savings in the long run, it was clear that ultimate benefits might be much reduced for system participants. This analysis caused the Commission members to focus on maintaining a defined benefit approach.

The Commission voted to recommend several changes that would reduce the cost of the system:

- Maximum Cost of Living Adjustment (COLA) at 3% and tied to Social Security. At present each person receives a COLA of three percent compounded annually⁸. The Commission voted in favor (4 agreed, 2 opposed, one abstention) to tie the benefit increase to the prior years Social Security income benefits increase, subject to a 3% maximum.
- Reduced Maximum Benefit The current system allows for a maximum retirement benefit of 80 percent of the average highest three consecutive years of pay. A majority of the Commission voted (5 agreed, 2 opposed) to reduce the maximum benefit to 70 percent as part of the decision to flatten the benefit factor (see diagram below). It was agreed to base the benefit on the average five consecutive years of service.

Equity with other plans

All members of the Commission were concerned with equity. The private sector participants were interested in recommending changes to cause the state system to be similar to quality private sector plans. These individuals were interested in shifting the investment risk to the employee by defining the contribution as the basis for the member benefit. The current system uses years of service and salary to define the benefit. It was also pointed out that employee participation, the minimum retirement requirements and maximum retirement benefit are more generous in the present state plan, and therefore inequitable to, private plans. Therefore, these individuals reasoned that changes should be made on the basis of equalizing the state plan with private sector plans.

Labor representatives were concerned with equity, but they felt that no changes should be made. They were concerned that if changes were instituted, the workforce would become "two-tiered". This would allow employees with different benefits to work side by side based solely upon date of initial hire.

This is an issue that cannot be resolved. One cannot provide equity with private sector plans and equity by retaining the status quo. In the end, changes were recommended by a majority of the members in regards to the benefits ratio, vesting, and the calculation of the cost of living ratio.

The goal of equity was also mentioned in the discussion of disability benefits. While the Commission did not come to closure on recommendations in this area, it did recommend further review of this topic. The Commission noted the potential inequity in the benefit formula based upon whether the disability occurred on or away from work.

Attract and Retain Career Employees

The current system was developed to attract and retain career employees. It allows for a weighted retirement benefit factor that places a higher value on long term employment⁹. The maximum benefit after 35 years of service is 80% of average highest three consecutive years of pay. This benefit is acknowledged to be valued by current career state employees.

Attract Non-career Employees - benefit formula

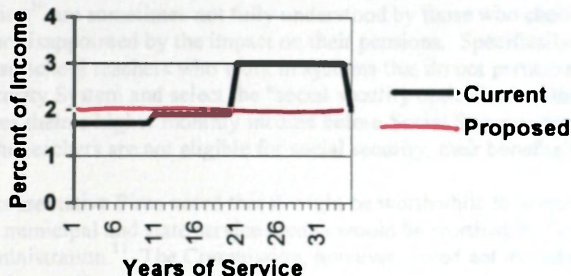
While the current system rewards long-term career employees, Chairman Carl noted that the workforce is changing, will continue to change, and the retirement system should accommodate these changes. He stated as a goal the need to encourage a diverse workforce that includes people who are interested in only working a portion of their career in State service.

A majority of the Commission agreed to two changes that would provide benefits to these employees.

- Vesting It was recommended to change the threshold to vest into the system from 10 to 5 years (6 agreed, 1 opposed, 1 abstention).
- Benefit Factor It was also agreed on a 5 to 2 vote to flatten the benefit factor to 2 percent of salary per year of service (see graph). The net impact of this change is to increase the retirement benefit paid to employees with less than 21 years of service and decrease the relative benefit for additional years of service. Note that this is the benefit formula for Rhode Island municipal employees.

⁹ The state employee income benefit formula currently allows for an income payable monthly for life equal to the benefit factor multiplied by the highest 3 consecutive years average earnings. The benefit factor is 1.7% for the first ten years of employment, 1.9% for years 11 to 20, 3% for years 21 to 34 and 2% in year 35.

Benefit Factor



In addition to these changes which were approved by a majority, two items were discussed to allow greater choice to employees who might make the plan more attractive. These items were not approved by a majority and include: allowing current state employees to opt into the new system and allowing a ten-year certain payment option. This option would allow a retiree to opt for a ten year guaranteed pay out, such that even if the member were to pass away prior to the ten years being completed. The remainder of the benefit could be treated as an inheritance.

Ability to Attract Employees - portability of benefits

The ability to transfer service credits or take service credits out as an employee enhances the value of a pension system to employees. Employers also benefit by being able to credit employees for valid leave time or service. The current system allows for several types of service credit to be purchased under a varied set of rules. The Commission agreed with this principle and did not recommend any changes regarding the purchase of service credits.

One change was, however, recommended by the Commission that would allow for increased options for certain employees leaving the system.

- Withdrawal from system Currently, if a vested employee leaves the system prior to retirement he/she is entitled to collect the earned portion of retirement benefits starting at age 60. The Commission discussed that there may some cases in which an employee may wish to receive benefits earlier even if the benefits are reduced in size. Therefore, it was recommended by a 4 to 3 majority that such employees be allowed to collect earlier if the benefit collected was discounted by the full actuarial value for each month preceding the age of sixty.

Ease of Administration and Communication

The Commission discussed the need to ensure clear communication to the members regarding the pension system generally. Also, it was noted that the public's perception of the costs and operations of the system occasionally differs from the actual operations

While the Commission did not feel that any changes in the system should be made solely for ease of administration or communication, two issues were raised in this regard. Ms. Reback expressed that the implications of the current social security option¹⁰ are sometimes not fully understood by those who choose this option and are later disappointed by the impact on their pensions. Specifically, Ms. Reback referenced those school teachers who work in systems that do not participate in the federal Social Security System and select the "social security option" when they retire. This option gives them a higher monthly income before Social Security payments start. Obviously, if the teachers are not eligible for social security, their benefits are lower.

Representative Pires noted that it might be worthwhile to investigate whether decoupling the municipal and state service credits would be worthwhile for clarity and ease of administration.¹¹ The Commission, however, voted not to make any changes in the service credit area.

Key Items Recommended:

Vesting **Reduce from 10 to 5 years**

Benefit Calculation .. **Change from a rate that pays more toward the end of a career to a flat 2% rate.**
..... **Lengthen base pay for benefit calculation from 3 to 5 consecutive highest years**

Pre-minimum Retirement **Allow for earlier retirement at a reduced compensation rate**

Cost of Living Increase **Tie the COLA to Social Security increase with a 3% maximum cap.**

Cost/Savings of Changes:

To be provided by the actuaries.

Conclusion:

The development of a pension system involves hard work and the balancing of a number of goals in a highly technical environment. The Special Commission to Study the Pension Commission for New Employees evaluated a number of options large and small to recommend changes to the existing system. In the end the Commission realized that major changes to the existing system would not yield large savings.

On the other hand, the Commission also found that the current system is significantly different both from private plans and other state plans. While the benefits to career employees are generous, the plan is less attractive to employees that who wish to work for the state only during a portion of their career. Given changes in the workforce generally, and the need to attract a diverse workforce, the Commission supported the need to make changes to accommodate these employees.

¹⁰ RIGL 36-10-10.3 "Social Security Supplemental Option"

¹¹ RIGL 36-9-20 "Credit for service as a teacher, municipal employee or legislator."

Report of the Special Commission to Study the Pension System for New Employees

Appendices:

A - Record of Decisions, October 7, 1997

B - Letter with questions to all consultants

C - Mercer proposed plan, June 11 memo

D - List of References

QUESTION	R C	D	A P	J R	J R	J P	K	TOTAL
Eligibility								
Should changes be made in the current membership requirements?	n	n	n	n	n	n	n	N
Employee Contribution								
Should the employee contribution levels continue at the same rate?	y	y	y	y	y	y	y	Y
If there are savings should they be shared between the employer and the employee?	y	y	y	n	n	n	y	Y
Service Credit								
Should all state and local service count toward employee contribution? ^{1,2}	y	a	n	y	y	y	y	Y
Should the practice of having the last employer pay the retirement benefits be continued?	y	a	n	y	y	y	y	Y
Purchased Service								
Should the current service purchase options be changed?	n	n	n	n	n	n	n	N
Benefit								
Should the variable rate be changed to a flat 2% rate?	y	y	y	y	n	n	y	Y
Should the base pay for calculating benefits be lengthened from 3 to 5 highest consecutive years of pay?	y	y	y	n	n	n	y	Y
Should the maximum number of eligible years be limited to 35?	y	y	y	n	n	n	y	Y
Vesting								
Should the vesting period be reduced from 10 to 5 years?	y	y	y	y	a	n	y	Y
Should vested participants be able to withdraw contributions plus credited interest?	y	y	n	n	n	n	y	N
Retirement Age								
Should a minimum retirement age, 55 years, be put in place for employees with 28 years of experience?	y	y	n	n	n	n	y	N
Should a vested employee be allowed to retire before 60 years of age or before achieving 28 years of service at a full actuarial discount for each month benefit preceding the age of 60? (1/2% per month)	y	y	n	y	n	n	y	Y
Payment Options								
Should a 10 year certain payment option be provided?	y	n	n	n	n	n	y	N
Should the multiple beneficiaries on joint and survivor benefits be removed?	n	n	n	y	n	n	n	N
Cost of Living Adjustment								
Should the COLA be tied to the prior years Social Security income benefits increase, subject to a 3% maximum?	y	y	a	y	n	n	y	Y
Should the COLA continue to be provided on a compounded basis?	y	a	y	y	y	y	a	Y
New issue								
Should existing employees be allowed to opt into the new system when it starts?	y	y	n	y	n	n	n	N



STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

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November 9, 1995

Mr. Frank Mangione, Principal
William M. Mercer, Inc.
200 Clarendon Street
Boston, MA 02116

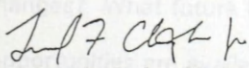
Dear Mr. Mangione:

I have been recently named by Governor Lincoln Almond to chair a Special Commission to Study the Alteration of the Pension System for New Employees. The purpose of this nine (9) member panel is to explore changes that may be applied to the pension program for new employees and to report to the Governor and to the General Assembly on such recommendations on or before March 1, 1996.

The Commission expects to employ a consultant to assist it in its deliberations. Prior to doing so, however, we are making a request of you, as well as several others in your field. We are interested in determining whether or not you would be willing to conduct a brief review of our existing plan on a pro bono basis, and make a brief presentation to the Commission concerning the available options which you believe the Commission might consider in developing a plan for new employees which is compatible with other states, cost effective to the taxpayers, and fair to new employees.

The Commission members would appreciate a 60-90 minute presentation with 30 minutes for questions and answers. If you are interested, please call Bob Tetreault at (401) 277-2155.

Sincerely,


b Robert L. Carl, Jr., Ph.D.
Acting Director
Department of Administration

IGT/RLC:en
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STATE OF RHODE ISLAND AND PROVIDENCE PLANTATIONS

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 Providence, R.I. 02908-5890

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November 30, 1995

Mr. Donald M. Overholser
 Buck Consultants
 200 Galleria Parkway, N.W.
 Suite 1200
 Atlanta, GA 30339

Dear Mr. Overholser:

The following questions have been submitted by commission members in anticipation of your presentation to our group next week:

- How do our plans compare to plans of other state governments:
 - In terms of cost to the State
 - In terms of cost to the participants
 - In terms of plan design
 - In terms of benefits under the plan
- How do benefits provided under our plans compare to benefits provided by private employers (particularly in New England) to their employees?
- What is the split among other states between defined benefit and defined contribution plans? Do some states provide both?
- For what types of state service or other service do other states allow service to be applied for pension eligibility? May the same service be applied to more than one pension? May service credits/time be purchased by participants?
- Considering the above, what have the recent trends been in state pension program changes? What future trends are projected?
- What cost saving opportunities are available to Rhode Island assuming no change in benefits or plan design under its current program(s)?

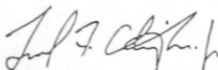
November 30, 1995
Mr. Donald M. Overholser
Page 2

It would also be helpful if you could give us some direction on the following issues and how they relate to other state plans:

- The benefits formula -- does the formula have a maximum, if so, what is it?
- Establishing normal retirement date
- Vesting
- Social Security integration
- Purchasing service time
- Return of contributions -- with interest?
- Coordination with a contributory pension plan

Thank you very much for agreeing to share your thoughts and ideas which will enable our commission to get our project in motion.

Sincerely,



for Robert L. Carl, Jr., Ph.D.
Acting Director

RLC/RGT:en
e8-90

Memorandum

Date: June 11, 1996

To: Dr. Robert Carl

From: Barry Gilman

Subject: Material for Next Meeting

Attached for your review is the material which we will plan to present for consideration of the Committee at the next meeting. Included is an overview of proposed plan provisions, and the resulting cost for the proposed pension plan for new State Employees and Teachers. We have modified this material in accordance with the Committee's discussions on June 10, and indicated revisions with **bold** type. We have also included a third attachment, in addition to the two attachments addressing the definition of compensation for pension purposes and the issues to be addressed regarding the purchase of additional benefit service, which have previously been provided. This third attachment presents an analysis of the disability provisions, which have been re-written. This analysis addresses whether or not to insure the nonoccupational disability benefit, the age at which nonoccupational disability benefits cease, the level of occupational and nonoccupational disability benefits, and the eligibility requirement for nonoccupational disability benefits.

Please provide this material to all committee members.

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Date: June 11, 1996

To: Rhode Island Special Commission on Retirement

From: Francis Mangione
Barry Gilman

Subject: Plan Design

The following represents a summary of the proposed plan (revising the current retirement plan), including revisions discussed by the committee at the last meeting on June 10, 1996. We also provide cost estimates of the plan and several alternative provisions:

Items Discussed and Conclusions

Eligibility	Unchanged from current plan for both State employees and Teachers.
Retirement Income Benefit	An annual retirement income payable monthly for life equal to 2% multiplied by the highest 5 consecutive years average earnings multiplied by service to a maximum of 35 years.
Employee Contributions	Continue to maintain some level of mandatory pre-tax contribution. Payment from the fund of employee contribution in the event of termination, death, or disability includes interest. Interest to be paid will be based on the rate earned by some external investment, such as passbook savings, or some flat amount, such as 3%. Interest will be determined on a simple rather than compound basis.
Service Credit	All full time state service as well as municipal service with a unit in the state maintained municipal plan, will count towards retirement. This assumes a transfer of any employee contributions in the municipal plan to the state plan when a municipal employee transfers into the state plan. The last employer pays the full benefit.
Purchased Service: See attachment for issues to be addressed	Very limited circumstances - up to four years of military credit. Teachers may purchase out of state and private school service. In no event will total purchased service exceed 5 years.
Vesting	Full 100% vesting after 5 years of service. Upon termination, a vested participant may withdraw

his/her contributions plus credited interest. If so, he or she forfeits any further benefit from the plan. (This may be subject to change in the future by US Congressional action.)

Compensation

Unchanged from current plan with respect to both State Employees and Teachers. (See attachment for details.)

Retirement Age

Accrued retirement benefit payable upon retirement after attainment of age 60 with 5 or more years of service or after attaining age 55 with 28 or more years of service. Retirement is available with a reduced benefit payable commencing at any age prior to attainment of age 55 once 28 years of service have been earned. The accrued retirement benefit will be reduced by 1/4% per month for each month benefit commencement precedes attainment of age 55.

Disability

Retain same occupational disability benefit level as current plan, which pays 2/3rds of compensation for the remainder of the disabled employee's life. **Provide the same level of benefit for a nonoccupational disability. Both occupational and nonoccupational disability benefits are reduced by benefits payable by other government sponsored programs (Worker's Compensation and Social Security). If a participant on nonoccupational disability survives to retirement age, a retirement benefit would be paid based on service credited before the date of disability plus the length of time while disabled through date of retirement. (Also attached is a discussion of "retirement age" for this purpose and an analysis of whether or not to insure the nonoccupational benefit.)**

Death

Provide same lump sum death benefit as currently provided for active and retired employees, but payable from a separate employer provided insured group plan. The Retirement Plan will also provide for return of employee contributions plus interest for death prior to retirement. Voluntary, additional pre-

retirement group life insurance will also be available from the insurer.

Benefit Payment Options

Maintain all current payment options except those noted in this section. Also, include a period certain option to allow a retiree to elect a reduced benefit payable for life with a guarantee of 120 monthly benefits to the retiree or, in the event of the retiree's death before 120 payments, the balance of the 120 monthly payments will be paid to a named beneficiary. Remove the option of selecting a different benefit after retirement by a retiree who elected one of the joint and survivor options. Also, remove the option of selecting multiple beneficiaries on Joint and Survivor benefit payments.

COLA

COLA to be provided commencing in the third year after retirement, same timing as current plan. Annual COLA increase equal to the prior year's increase provided on Social Security retirement income benefits, subject to maximum annual increase of 3% COLA provided on a compound basis.

Cost

It has not yet been determined what the ongoing contribution level should be for the state and for the participants.

We have estimated the total cost for the plan detailed above based on the following assumptions:

1. The average age at date of hire for the new hires will be similar to the current group of employees. Please note that our cost is very sensitive to this assumption. For example, if the vast majority of new hires are in their early 20's and they do elect to retire until age 60 or later, the current level of employee contributions will fully pay for their benefits, with little or no additional employer contributions.
2. All actuarial assumptions are the same as those used in the 6/30/95 actuarial valuation of the Retirement System, featuring an interest rate of 8% and annual salary increases of 4.5%.

3. We have not included any cost savings expected to be generated by insuring the nonoccupational disability and group life benefits. Insurance quotations should be solicited.

Estimated cost for the benefits detailed above are as follows:

State		Teachers	
Current Plan	Proposed Plan	Current Plan	Proposed Plan
13.00%	11.75%	14.25%	12.50%
	30 year max (0.25%) Simple COLA (0.35%)		30 year max (0.40%) Simple COLA (0.40%)

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Definition of Compensation Under Title 36

The term "Compensation" ... shall mean salary or wages earned and paid for the performance of duties for covered employment, including regular longevity or incentive plans approved by the board, but shall not include payments made for overtime or reasons other than performance of duties or activities, including but not limited to the types of payment listed below:

- (A) Payments contingent on the employee having terminated or died;
- (B) Payments made at termination for unused sick leave, vacation leave, or compensatory time;
- (C) Payments contingent on the employee terminating employment, at a specified time in the future to secure voluntary retirement or to secure release of an unexpired contract of employment;
- (D) Individual salary adjustments which are granted primarily in anticipation of the employee's retirement;
- (E) Additional payments for performing temporary or extra duties beyond the normal or regular work day or work year.

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Issues Regarding the Purchase of Service

At the June 4, 1996 meeting of the Committee, there was discussion concerning the opportunity for plan participants to purchase additional service for benefit purposes under the circumstances noted below. It is also necessary for the Committee to determine the price to purchase the additional service and the time limit during which the service may be purchased.

1. An employee in a municipal pension plan which participates in the Municipal Employees Retirement System of Rhode Island will be allowed to transfer his service credits in the municipal plan to the State's plan? Please note that the proposed retirement income benefit formula for new hires provides the same 2% annual accrual rate as for the municipal plan administered by the State. (However, the proposed plan bases benefits on 5-year average compensation while the municipal plan benefit is based on 3-year average compensation. Also, the maximum benefit under the municipal plan is 75% of 3-year average compensation while the proposed plan would provide a maximum benefit of 70% of 5-year average compensation.) At the time of transfer, the Municipal Plan will pay to the State Plan both the employee's contributions (and accumulated interest, if any, plus any difference between the full actuarial value of the accrued benefit and the value of the employee contributions (and accumulated interest, if any).
2. An employee in a municipal pension plan which does not participate in the Municipal Employees Retirement System of Rhode Island will not be allowed to transfer his vested service credits in the municipal plan to the State's plan. However, he may transfer up to 5 years of nonvested service credit under item #3.
3. An employee will be allowed to purchase service performed as a public employee or teacher in another state or in a municipal pension plan which does not participate in the Municipal Employees Retirement System of Rhode Island provided that his service does not provide a vested retirement benefit from another pension plan. The employee may purchase up to 5 years of such "nonvested" service (including military service, item #5 below) at full actuarial cost. The purchase must occur within two years after date of hire.
4. Should an employee be allowed to purchase service time while on an approved leave of absence, such as a maternity leave?
5. Should an employee be allowed to purchase service while serving in the U.S. military?
6. Should an employee be allowed to re-purchase service earned while a state employee, teacher, or municipal employee which was forfeited as a result of

the employee electing to take his or her employee contributions (and interest, if any) when he or she terminated employment previously?

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Issues Regarding Disability Benefits

Insurance: The nonoccupational disability benefit payable by the current plan is taxable to disabled retirees. (We are informed that the occupational disability benefit is received tax free.) We had proposed removing this form of benefit from the pension plan and providing the benefit from an insured Long Term Disability Plan. If the employee pays for the disability benefit on an after-tax basis, any disability payments would be receivable tax-free. However, the Committee has decided not to charge employees for this benefit, and, thus, the benefit payable under the insurance policy is subject to taxation. During our meeting of June 10, it was discussed that disability benefits begin at the end of accumulated sick leave. This differs for each employee. An insurer may require a fixed minimum period before payments would commence, such as 90 or 180 days (but no less than accumulated sick leave). Thus, the plan may remain responsible for disability payments until the minimum wait period is satisfied. It is also unusual for insured long term disability benefits to be subject to annual cost of living increases, and this may present a problem. Balancing these negatives is the opportunity for the plan to provide the benefit in a less expensive manner with insurance as opposed to funding it as part of the pension plan; and the opportunity to allow insurance company claims reviewers to determine whether someone is eligible for disability benefits and to monitor their ongoing disability status.

Age at Which Disability Benefits Cease: It is common for insured plans to provide disability benefits until attainment of age 65, Social Security Retirement Age for older employees (although if disability commences after attainment of age 60, there might be a minimum of 5 years of payments). The Committee has discussed that a nonoccupationally disabled participant would be eligible to receive a retirement income benefit when disability payments cease, based on service earned up to the date of disability plus additional service which would be credited while the employee is disabled. Thus, a nonoccupationally disabled participant would receive his disability income and then switch to a retirement income based on the service which he would have earned, had he remained employed through "retirement age" and not been disabled. We propose that a disabled individual be allowed to receive disability benefits through attainment of age 65 and then a retirement income benefit should commence, based on deemed service through age 65 and final average compensation as of date of disability, whether or not insurance is pursued. Naturally, if an individual is eligible to elect to retire at time of disability and receive a benefit larger than the disability income benefit, he would elect actual retirement at that time.

Benefit Level: Occupational disability benefit is currently 2/3rds of compensation, less Worker's Compensation. An equal benefit has been proposed for nonoccupational disability, less Social Security disability benefits. We propose that the occupational disability benefit also be offset by receipt of any Social Security benefit.

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Eligibility: Currently, employees are eligible immediately upon hire for an occupational disability benefit, but must be employed for five years before attaining eligibility for the nonoccupational disability benefit. The Committee has not addressed whether to retain the five year eligibility requirement for nonoccupational disability benefits.

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