House of Representatives

General Assembly

File No. 696

January Session, 2007

Substitute House Bill No. 6141

House of Representatives, May 2, 2007

The Committee on Finance, Revenue and Bonding reported through REP. STAPLES of the 96th Dist., Chairperson of the Committee on the part of the House, that the substitute bill ought to pass.

AN ACT CONCERNING ADEQUATE FUNDING OF THE TEACHERS' RETIREMENT SYSTEM.

Be it enacted by the Senate and House of Representatives in General Assembly convened:

Section 1. (NEW) (*Effective July 1, 2007*) The State Bond Commission shall have power, in accordance with the provisions of sections 1 to 8, inclusive, of this act, from time to time to authorize the issuance of bonds of the state in one or more series and in principal maturity amounts which in the aggregate generate proceeds sufficient to fund two billion dollars of the unfunded liability of the Teachers' Retirement Fund and to pay the costs of issuing such bonds and up to two years of interest on such bonds.

Sec. 2. (NEW) (*Effective July 1, 2007*) The proceeds of the sale of such bonds, to the extent hereinafter stated, shall be used for the purpose of: (1) Reducing the unfunded liability, as such term is defined in section 10-183b of the general statutes, of the Connecticut teachers' retirement system, and (2) paying or providing for the costs related to the

14 issuance of the bonds, including the initial costs of agreements and
15 contracts permitted under section 3-20a of the general statutes with
16 respect to such bonds, and up to two years of interest on such bonds.

17 Sec. 3. (NEW) (*Effective July 1, 2007*) Except as provided in section 5
18 of this act, all provisions of section 3-20 of the general statutes or the
19 exercise of any right or power granted thereby which are not
20 inconsistent with the provisions of this act are hereby adopted and
21 shall apply to all bonds authorized by the State Bond Commission
22 pursuant to sections 1 to 8, inclusive, of this act, and temporary notes
23 issued in anticipation of the money to be derived from the sale of any
24 such bonds so authorized may be issued in accordance with said
25 section 3-20 and from time to time renewed. Such bonds shall mature
26 at such time or times not exceeding thirty years from their respective
27 dates as may be provided in or pursuant to the resolution or
28 resolutions of the State Bond Commission authorizing such bonds.

29 Sec. 4. (NEW) (*Effective July 1, 2007*) None of said bonds shall be
30 authorized except upon a finding by the State Bond Commission that
31 there has been filed with it (1) a request for such authorization, which
32 is signed by the Secretary of the Office of Policy and Management or
33 on behalf of such state officer and stating such terms and conditions as
34 said commission, in its discretion, may require, and (2) a written
35 determination by the State Treasurer and the Secretary of the Office of
36 Policy and Management that the issuance of the bonds is in the best
37 interests of the state.

38 Sec. 5. (NEW) (*Effective July 1, 2007*) Proceeds of the bonds issued
39 under sections 1 to 8, inclusive, of this act and all earnings on
40 investments of proceeds of such bonds, to the extent not applied to the
41 payment of costs related to the issuance thereof, shall be deposited in
42 the custody of the State Treasurer in the fund for the Connecticut
43 teachers' retirement system and, notwithstanding section 3-20 of the
44 general statutes, shall be invested by the State Treasurer in the manner
45 provided in section 3-13d of the general statutes for trust funds.

46 Sec. 6. (NEW) (*Effective July 1, 2007*) Said bonds issued pursuant to

47 sections 1 to 8, inclusive, of this act, shall be general obligations of the
48 state and the full faith and credit of the State of Connecticut are
49 pledged for the payment of the principal of and interest on said bonds
50 as the same become due, and accordingly and as part of the contract of
51 the state with the holders of said bonds, appropriation of all amounts
52 necessary for punctual payment of such principal and interest is
53 hereby made, and the State Treasurer shall pay such principal and
54 interest as the same become due. Any net premium realized from the
55 sale of said bonds shall be deemed appropriated to the payment of
56 debt service on any bonds issued under this act, and the State
57 Treasurer may apply such net premium to payment of such debt
58 service.

59 Sec. 7. (NEW) (*Effective July 1, 2007*) Notwithstanding any provision
60 of section 3-21 of the general statutes to the contrary, bonds authorized
61 and bonds issued under sections 1 to 8, inclusive, of this act and any
62 refunding bonds shall not be subject to the debt limitation in section 3-
63 21 of the general statutes and shall not be included in indebtedness of
64 the state for purposes of calculating the amount of indebtedness of the
65 state which is subject to the debt limitation of section 3-21 of the
66 general statutes, and sections 1 to 8, inclusive, of this act and action of
67 the State Bond Commission shall not require any certification of the
68 State Treasurer under section 3-21 of the general statutes.

69 Sec. 8. (NEW) (*Effective July 1, 2007*) Each fiscal year that any bonds
70 authorized by sections 1 to 8, inclusive, of this act or any refunding
71 bonds are outstanding, there shall be deemed appropriated from the
72 General Fund of the state the amount equal to the annual required
73 contribution to the fund for the Connecticut teachers' retirement
74 system and such amount shall be deposited by the Treasurer in the
75 fund for the Connecticut teachers' retirement system in quarterly
76 allotments on July fifteenth, October first, January first and April first
77 of such fiscal year. The amount of the annual required contribution
78 shall be determined in accordance with the provisions of subsection (b)
79 of section 10-183*l* and section 10-183z of the general statutes, as
80 amended by this act, and for each biennial budget shall be the amounts

81 for the fiscal years of said biennium determined in the actuarial
82 evaluation required to be submitted by the December first prior to the
83 beginning of the first fiscal year of the biennium, as provided in said
84 subsection (b) of section 10-183*l*, beginning with the actuarial
85 evaluation submitted prior to December 1, 2006, for the biennial
86 budget for the fiscal years commencing July 1, 2007, and July 1, 2008.
87 Said amount shall be certified by the Teachers' Retirement Board and
88 the Comptroller. The state of Connecticut does hereby pledge to and
89 agree with the holders of any bonds issued under sections 1 to 8,
90 inclusive, of this act and any refunding bonds that, as long as the
91 actuarial evaluation for each biennium, as required by this section, and
92 the certification of the annual contribution amounts, as required by
93 this section, are completed in the manner and by the dates required by
94 this section, subsection (b) of section 10-183*l* of the general statutes and
95 subsection (a) of section 10-183z of the general statutes, as amended by
96 this act, no public or special act of the General Assembly shall diminish
97 such required contribution until such bonds, together with the interest
98 thereon, are fully met and discharged, provided nothing herein
99 contained shall preclude such limitation or alteration if and when
100 adequate provision shall be made by law for the protection of the
101 holders of such bonds. The State Treasurer is authorized to include this
102 pledge and undertaking for the state in such bonds.

103 Sec. 9. Section 10-183c of the general statutes is repealed and the
104 following is substituted in lieu thereof (*Effective July 1, 2007*):

105 (a) The Connecticut teachers' retirement system is established to
106 provide retirement and other benefits for teachers, their survivors and
107 beneficiaries. On or after a member vests in the system by becoming
108 eligible to receive a retirement benefit pursuant to section 10-183f, or
109 accumulates ten years of credited service in the system, as defined in
110 subsection (a) of section 10-183e, whichever is later, the member's
111 benefit under sections 10-183e, 10-183f, 10-183g, 10-183h and 10-183aa
112 is contractual in nature and no public or special act of the General
113 Assembly shall diminish such benefit, provided this section shall apply
114 only to an active member who is vested on October 1, 2003, or to a

115 member who vests or accumulates ten years of credited service on or
116 after October 1, 2003, and shall apply to the member's benefit in
117 existence on October 1, 2003, or to the member's benefit in existence on
118 the date the member vests or accumulates ten years of credited service,
119 respectively, whichever is later. **[**Nothing in this section shall affect the
120 provisions of section 10-183t or 10-183z. On or after October 1, 2003,
121 any public or special act enhancing the benefits of the system shall be
122 subject to the provisions of this section. **]**

123 (b) In addition to the benefits described in subsection (a) of this
124 section, upon the issuance of bonds authorized by sections 1 to 8,
125 inclusive, of this act, all benefits of all members of the teachers'
126 retirement system as of said issuance shall be construed to be
127 contractual in nature, as long as the bonds issued in accordance with
128 sections 1 to 8, inclusive, of this act, or any subsequent
129 reauthorizations of said bonds remain outstanding.

130 (c) Nothing in this section shall affect the provisions of section 10-
131 183t or 10-183z, as amended by this act.

132 Sec. 10. Subsection (l) of section 10-183g of the general statutes is
133 repealed and the following is substituted in lieu thereof (*Effective July*
134 *1, 2007*):

135 (l) (1) Beginning the first day of January or July which follows nine
136 months in retirement, a retired member who retired on or after
137 September 1, 1992, or a member's successor beneficiary, except a
138 person receiving survivor's benefits, shall be eligible for an annual cost
139 of living allowance. **[**for each year in which the plan actuaries have
140 certified under the provisions of subsection (n) of this section that
141 sufficient funds are available.**]** The cost of living allowance shall be
142 calculated by using the percentage cost of living adjustment granted
143 by the Social Security Administration for the applicable year,
144 computed on the basis of the retirement benefits to which such retired
145 member or successor beneficiary was entitled on the last day of the
146 preceding December or June except benefits based upon one per cent
147 or voluntary contributions, provided no cost of living allowance shall

148 exceed six per cent and provided further, if the total return earned by
149 the trustees on the market value of the pension assets for the preceding
150 fiscal year is less than eight and one-half per cent, any cost of living
151 allowance granted shall not exceed one and one-half per cent.

152 (2) A member entering the retirement system commencing on or
153 after July 1, 2007, or such member's successor beneficiary, except a
154 person receiving survivor's benefits, shall, beginning the first day of
155 January or July that follows nine months in retirement, be eligible for
156 an annual cost of living allowance as follows: The cost of living
157 allowance shall be calculated by using the percentage cost of living
158 adjustment granted by the Social Security Administration for the
159 applicable year, computed on the basis of the retirement benefits to
160 which such retired member or successor beneficiary was entitled on
161 the last day of the preceding December or June, as applicable, except
162 benefits based upon one per cent of voluntary contributions, provided
163 (A) no cost of living allowance shall exceed five per cent, and (B) if the
164 total return earned by the trustees on the market value of the pension
165 assets for the preceding fiscal year is less than eight and one-half per
166 cent, any cost of living allowance granted shall not exceed one per
167 cent, if such total return for the preceding fiscal year is greater than
168 eight and one-half per cent but less than eleven and one-half per cent,
169 any cost of living allowance granted shall not exceed three per cent,
170 and if such return exceeds eleven and one-half per cent, any cost of
171 living allowance granted shall not exceed five per cent.

172 Sec. 11. Section 10-183i of the general statutes is repealed and the
173 following is substituted in lieu thereof (*Effective July 1, 2007*):

174 (a) A member may make voluntary contributions to the system and
175 may, no more than once, withdraw such voluntary contributions from
176 the system under rules of the board. Such contributions shall earn
177 credited interest, which shall be the actual rate of return earned by the
178 funds of the system in the immediately concluded fiscal year. The State
179 Treasurer shall certify the investment return to the Retirement Board
180 on or before September first following the close of the fiscal year, and

181 such interest shall be applied to a member's account based on the
182 balance as of the previous June thirtieth.

183 (b) Upon retirement such member shall elect to receive the
184 accumulated contributions plus credited interest either in a lump sum
185 or in the form of an actuarially equivalent annuity for life. Such lump
186 sum or annuity shall be paid or commenced to be paid when the first
187 payment of such member's other retirement benefit is made. If such
188 member dies before the effective date of his or her retirement, the
189 accumulated contributions plus credited interest shall be paid to such
190 member's designated beneficiary.

191 Sec. 12. Section 10-183r of the general statutes is repealed and the
192 following is substituted in lieu thereof (*Effective July 1, 2007)*:

193 The system shall be funded as follows:

194 (1) All expenses of the administration of the system, exclusive of
195 payment of benefits, shall be paid for out of amounts appropriated by
196 the General Assembly on certifications and recommendations
197 submitted by the board.

198 (2) The cost of all benefits payable from the system shall be paid out
199 of the retirement fund which shall consist of contributions paid by
200 members, appropriations by the General Assembly based upon
201 certifications and recommendations submitted by the board, the
202 proceeds of bonds held by the system under section 10-183m, the
203 proceeds of bonds issued pursuant to sections 1 to 8, inclusive, of this
204 act, and earnings of the system.

205 Sec. 13. Subsection (a) of section 10-183z of the general statutes is
206 repealed and the following is substituted in lieu thereof (*Effective July*
207 *1, 2007*):

208 (a) The retirement system for teachers shall be funded on an
209 actuarial reserve basis. The retirement board shall, on or before the
210 December first**[**, annually**]** which precedes the first fiscal year of the
211 next biennial state budget, certify to the General Assembly the

212 [amount] amounts necessary for each fiscal year of the biennium, on
213 the basis of an actuarial determination to establish and maintain the
214 retirement fund on such determined actuarial reserve basis and make
215 such other recommendations with regard to the fund and its
216 administration as the board deems necessary. On the basis of each
217 evaluation, the retirement board shall redetermine the normal rate of
218 contribution and, until it is amortized, the unfunded past service
219 liability. The General Assembly shall review the board's
220 recommendations and certification and shall appropriate to the
221 retirement fund the [amount] amounts certified by the retirement
222 board as necessary, provided said certification is in compliance with
223 this section. The retirement board shall, on or before the December first
224 which precedes the second fiscal year of the biennium, prepare and
225 submit to the General Assembly revised actuarial determinations,
226 including a revised annual required contribution for the second fiscal
227 year of the biennium.

228 Sec. 14. (NEW) (*Effective July 1, 2007*) Effective July 1, 2007, the cost
229 of living adjustment reserve account created by subsection (n) of
230 section 10-183g of the general statutes shall cease, and all funds
231 credited to such account shall be credited to, and remain within, the
232 Teachers' Retirement Fund.

233 Sec. 15. Subsections (m) and (n) of section 10-183g of the general
234 statutes are repealed. (*Effective July 1, 2007*)

This act shall take effect as follows and shall amend the following sections:		
Section 1	*July 1, 2007*	New section
Sec. 2	*July 1, 2007*	New section
Sec. 3	*July 1, 2007*	New section
Sec. 4	*July 1, 2007*	New section
Sec. 5	*July 1, 2007*	New section
Sec. 6	*July 1, 2007*	New section
Sec. 7	*July 1, 2007*	New section
Sec. 8	*July 1, 2007*	New section
Sec. 9	*July 1, 2007*	10-183c

Sec. 10	*July 1, 2007*	10-183g(l)
Sec. 11	*July 1, 2007*	10-183i
Sec. 12	*July 1, 2007*	10-183r
Sec. 13	*July 1, 2007*	10-183z(a)
Sec. 14	*July 1, 2007*	New section
Sec. 15	*July 1, 2007*	Repealer section

APP *Joint Favorable C/R* FIN

FIN *Joint Favorable Subst.*

The following fiscal impact statement and bill analysis are prepared for the benefit of members of the General Assembly, solely for the purpose of information, summarization, and explanation, and do not represent the intent of the General Assembly or either chamber thereof for any purpose:

OFA Fiscal Note

State Impact:

Agency Affected	Fund-Effect	FY 08 $	FY 09 $
Treasurer, Debt Serv.	GF - Cost	47 million	47 million
Teachers' Retirement Bd.	GF - Savings	See Below	See Below

Note: GF=General Fund

Municipal Impact: None

Explanation

General Fund Impact

The bill authorizes the Office of the State Treasurer (OST) to issue $2 billion (plus issuance costs and up to 2 years of interest on the bonds) in Pension Obligation Bonds (POBs) for a term of 25 years and to deposit the proceeds of the bond sale in the Teachers' Retirement Fund (TRF).

1. The net impact of the bill over 25 years is projected to be a savings of $2.76 billion in General Fund (GF) contributions to the TRF. The estimate is based on a financing plan for the POBs developed by OST. (A summary of the assumptions used in the financing plan appears at the end of the fiscal note.)

Projected General Fund Savings due to sHB 6141
($ billions)

	Projected ARC[1] under current law (based on 7.3% rate of return)	General Fund cost for ARC (based on 8.5% rate of return) and debt service	General Fund Savings
25 year impact	31,383.5	28,625.9	(2,757.6)

[1] Actuarial Recommended Contribution (ARC)

2. Issuing POBs is expected to result in GF debt service costs of $47 million in each of FY 08 and FY 09. The GF debt service cost to bond $2 billion in POBs over 25 years at a 5.6% interest rate is estimated to be $4.54 billion.

3. The financing plan developed by OST assumes the use of $100 million ($50 million in each of FY 08 and FY 09). It should be noted that sHB 7077, the budget bill favorably reported by the Appropriations Committee, includes $10 million for FY 08 for this purpose.

4. The bill excludes the POBs from the statutory cap on General Obligation (GO) bonds.

Teachers Retirement Fund (TRF) Impact

1. The net impact of the bill on the TRF is to decrease the fund's liability by approximately $1 billion. This is the result of:

   a. A $3.6 billion increase in assets from: (1) depositing the $2 billion in POB proceeds into the TRF and (2) eliminating the Cost of Living Adjustment Reserve Account (CLARA) account and adding the current CLARA assets of $1.6 billion to the TRF; and

   b. A $2.6 billion increase in liabilities from reinstating the guaranteed cost of living adjustments (COLAs) for teachers who retire on or after September 1, 1992.

Change in TRF Assets and Liabilities due to sHB 6141	
Increase in assets:	$1.6 billion transferred from CLARA $2.0 billion from the POB issuance **$3.6 billion total increase in TRF assets**
Increase in liabilities:	**$2.6 billion from reinstatement of guaranteed COLA**
Net Impact	**$1 billion decrease in TRF Unfunded Liability**

2. The bill deems appropriated the full amount required to fund the full ARC payment annually for the TRF for the 25-year term of the POBs. This precludes the possibility that the state will accumulate another unfunded liability due to underpayment of the ARC during the life of the POBs. It also significantly improves the TRF's funded ratio over the long term.

Further Explanation

The fiscal impact of this bill is based on a set of assumptions that are summarized at the end of the fiscal note.

Elimination of CLARA and Reinstatement of COLA Guarantee

Under current law, any annual investment income in excess of 11.5% in the Teachers Retirement Fund (TRF) is deposited into the Cost of Living Adjustment Reserve Account (CLARA) and used to pay an annual cost of living adjustment (COLA) for teachers who retired on or after September 1, 1992. Removing investment income in excess of 11.5% from the TRF places a cap on the maximum amount of return that the fund can earn, which has reduced the rate of return on the fund from 8.92% to 7.29%[1] over a period of 15 years (FY 91 to FY 05). Since the state's annual Actuarial Recommended Contributions[2] (ARC) to the TRF is calculated based on an assumed average rate of return on the TRF of 8.5%, the Office of the State Treasurer has indicated that plan liabilities, costs and unfunded liability amortization are understated and has recalculated the ARC between FY 10 to FY 32[3] to reflect the lower earnings of 7.29%. Table 1 shows the difference between projected ARC payments between FY 10 and FY 14 using these two different rates of return assumptions and also the 25-year impact.

Table 1
($ millions)
Difference between Actuarial Recommended Contribution (ARC) and ARC adjusted for Actual Rate of Return on the Teachers Retirement Fund (TRF)

	8.5% Rate of Return for TRF			7.3% Rate of Return for TRF	
Fiscal Year	Normal Cost[1]	UAAL[2]	Total ARC	Total ARC[3]	Difference
	a	b	a+b=c	d	d-c=e

[1] Based on information provided by the Office of the State Treasurer
[2] The Actuarial Recommended Contribution (ARC) is composed of: (1) the normal cost, which is the TRF liability for the current year and (2) the Unfunded Actuarial Accrued Liability (UAAL), which is the unfunded liability from prior years.
[3] The Office of the State Treasurer contracted with Bear Stearns & Co., Inc to provide an analysis of the impact of the lower rate of return on the state's ARC from FY 10 to FY 32.

FY 08	98.1	420.5	518.6	518.6	0.0
FY 09	102.0	437.3	539.3	539.3	0.0
FY 10	106.1	461.4	567.5	617.8	50.4
FY 11	110.3	479.8	590.2	654.8	64.6
FY 12	114.7	499.0	613.8	693.2	79.5
FY 13	119.3	513.2	632.5	727.5	95.0
FY 14	124.1	533.7	657.8	769.0	111.2
25 year impact	4,084.6	21,136.1	25,220.6	31,383.5	6,162.8

[1] TRF payment for current year provided by Gabriel Roder Smith & Co., the consulting actuary for the Teachers' Retirement System.
[2] Unfunded Actuarial Accrued Liability from prior years year provided by Gabriel Roder Smith & Co., the consulting actuary for the Teachers' Retirement System.
[3] Estimated ARC provided to the Office of the State Treasurer by with Bear Stearns & Co., Inc.

sHB 6141: (1) eliminates the CLARA account, (2) adds the current CLARA assets in the TRF and (3) reinstates guaranteed COLAs to teachers who retire on or after September 1, 1992. The impact of these changes is as follows:

Elimination of the CLARA account: Eliminating the CLARA account removes the cap on the maximum amount of return that the TRF can earn. It is anticipated that this will increase the TRF's average rate of return to the actuarially assumed rate of 8.5%.

Addition of CLARA assets to the TRF: Addition of the CLARA account assets to the TRF will increase the amount of investment income earned by the fund. As of 6/30/06, there were $1.6 billion in assets in the CLARA account.

Reinstatement of COLA Guarantee: The COLA guarantee is expected to result in a $2.63 billion increase the Actuarial Accrued Liability of the General Fund to the TRF.

These three changes are expected to result in a net increase $5.1 billion in the General Fund's ARC payments over the next 25 years. Table 2 summarizes the ARC increases between FY 08 and FY 14, and shows the 25-year impact:

Table 2
($ millions)

Net Increase in ARC Payments[1] due to: (1) Elimination of CLARA, (2) Addition of CLARA Assets to TRF, and (3) Reinstatement COLA Guarantee	
Fiscal Year	Net Increase in ARC
FY 08	121.4
FY 09	126.2
FY 10	131.3
FY 11	136.5
FY 12	142.0
FY 13	147.7
FY 14	153.6
25-year impact	5,055.3

[1] Estimates provided to the Office of the State Treasurer by with Bear Stearns & Co., Inc.

Issuance of Pension Obligation Bonds

sHB 6141 authorizes the Office of the State Treasurer to: (1) issue $2 billion (plus issuance costs and up to 2 years of interest on the bonds) in POBs for a term of 25 years and (2) to deposit the proceeds of the bond sale in the TRF. The impact of these changes is as follows:

Issuance of $2 billion in POBs: The GF debt service cost to bond $2 billion in POBs over 25 years at a 5.6% interest rate is estimated to be $4.54 billion.

Transfer of $2 billion to the TRF: Transferring $2 billion to the TRF will reduce the TRF's unfunded liability, which will reduce General Fund ARC payments[4].

Table 3 summarizes the anticipated net reduction in General Fund costs for these two changes between FY 08 and FY 14, and shows the 25-year impact.

Table 3
($ millions)
Net General Fund Impact of Issuing $2 billion in POBs[1]

Fiscal Year	Reduction in ARC	POB Debt Service	Net General Fund Impact

[4] ARC (Actuarial Recommended Contribution) payments are composed of: (1) the normal cost, which is the TRF liability for the current year and (2) the UAAL (Unfunded Actuarial Accrued Liability), which is the unfunded liability from prior years. Transferring $2 billion into the TRF will reduce the unfunded liability from prior years or UAAL component of the payment.

	a	b	a+b=c
FY 08	(124.1)	47.0	(77.1)
FY 09	(127.7)	47.0	(80.7)
FY 10	(132.8)	51.0	(81.8)
FY 11	(138.1)	65.3	(72.8)
FY 12	(143.6)	80.9	(62.7)
FY 13	(147.7)	94.7	(53.0)
FY 14	(153.6)	111.0	(42.6)
25-year impact	(6,091.4)	4,541.4	(1,550.0)

[1] Estimates provided to the Office of the State Treasurer by with Bear Stearns & Co., Inc.

Use of $100 million in FY 07 Budget Surplus

1. sHB 6141 assumes that $100 million of the projected FY 07 operating budget surplus will be used to reduce the General Fund's liability for this bill ($50.0 million in each of FY 08 and FY 09 - see Table 4). It should be noted that sHB 7077, the budget favorably reported by the Appropriations Committee includes $10 million for FY 08 for this purpose.

Table 4
($ millions)
Projected Use of FY 07 Budget Surplus[1]

Fiscal Year	Use of FY 07 Surplus
FY 08	(50.0)
FY 09	(50.0)
Total	**(100.0)**

[1] Estimates provided to the Office of the State Treasurer by with Bear Stearns & Co., Inc.

Net Impact of sHB 6141

Table 5 summarizes the net cost to the General Fund between FY 08 and FY 14 for:

1. Elimination of CLARA and COLA Guarantee (Table 2),
2. Issuance of Pension Obligation Bonds (Table 3), and
3. Use of $100 million in FY 07 Budget Surplus (Table 4)

Table 5
($ millions)
Net General Fund Cost for sHB 6141

Table 1	Table 2	Table 3	Table 3	Table 4

Fiscal Year	ARC based on 8.5% rate of return[1]	CLARA/ COLA ARC Increase[2]	POB ARC Reduction[2]	Revised ARC	POB Debt Service[2]	FY 07 Surplus[2]	**Net General Fund Cost**
	A	b	C	a+b+c=d	E	f	d+e+f=g
FY 08	518.6	121.4	(124.1)	515.9	47.0	(50.0)	512.9
FY 09	539.3	126.2	(127.7)	537.8	47.0	(50.0)	534.8
FY 10	567.5	131.3	(132.8)	566.0	51.0	0.0	617.0
FY 11	590.2	136.5	(138.1)	588.6	65.3	0.0	653.9
FY 12	613.8	142.0	(143.6)	612.2	80.9	0.0	693.1
FY 13	632.5	147.7	(147.7)	632.5	94.7	0.0	727.2
FY 14	657.8	153.6	(153.6)	657.8	111.0	0.0	768.8
25-year impact	25,220.6	5,055.3	(6,091.4)	24,184.5	4,541.4	(100.0)	28,625.9

[1] Figures provided by Gabriel Roder Smith & Co., the consulting actuary for the Teachers' Retirement System.
[2] Estimates provided to the Office of the State Treasurer by with Bear Stearns & Co., Inc.

Table 6 compares between FY 08 and FY 14: (1) the General Fund cost for ARC payments under current law, assuming a 7.3% rate of return on the TRF (Table 1) and (2) the net General Fund cost due to sHB 6141 (Table 5):

Table 6
($ millions)
Comparison of ARC assuming 7.3% Rate of Return vs Net General Fund Cost associated with sHB 6141[1]

Fiscal Year	Table 1 Current Law ARC based on 7.3% rate of return	Table 5 sHB 6141 Net General Fund Cost	**Difference**
	a	b	b-a=c
FY 08	518.6	512.9	(5.7)
FY 09	539.3	534.8	(4.5)
FY 10	617.8	617.0	(0.8)
FY 11	654.8	653.9	(0.9)
FY 12	693.2	693.1	(0.1)
FY 13	727.5	727.2	(0.3)
FY 14	769.0	768.8	(0.2)
25-year impact	31,383.5	28,625.9	(2,757.6)

[1] All estimates provided to the Office of the State Treasurer by with Bear Stearns & Co., Inc.

The budget, sHB7077 as approved by the Appropriations Committee, fully funds the state's contribution (ARC) to the TRF in FY 08 ($518.6 million) and in FY 09 ($539.3) through the use of General Fund appropriations and FY 07 surplus funding.

Risk to the General Fund

The interest rate assumptions on which this fiscal analysis is based

are that the POBs will be issued at an average interest rate of 5.6% and the bond proceeds invested in the TRF will earn an average rate of return of 8.5%. The difference (or spread) of 2.9% between these two interest rates makes this transaction financially advantageous for the GF.

The risk to the GF is that the spread between the two interest rates will be less than 2.9%. This could result from: (1) the issuance of POBs at an average rate higher than 5.6%, (2) an average investment rate of return on the TRF lower than 8.5%, or (3) a combination of the two.

Impact of deeming ARC payments as appropriated over life of POBs

The bill deems appropriated the full amount required to fund the full ARC[5] payment annually for the TRF for the 25-year term of the POBs. It also permits the Office of the State Treasurer to include a clause in the POB bond indenture pledging to purchasers of the bonds that the state will make full ARC payments. The intent of the provision is to ensure that the state will not accumulate another unfunded liability due to underpayment of the ARC during the life of the outstanding POBs.

Impact on the Teachers' Retirement System (TRS)

Teachers' Retirement Fund (TRF) Assets and Liabilities

Table 8 shows that immediate impact of sHB 6141 on the TRF is to: (1) increase assets by $3.6 billion and (2) increase liabilities by $2.6 billion. The net impact of these changes is to decrease the TRF's unfunded liability by $1 billion.

Table 8	
Change in TRF Assets and Liabilities due to sHB 6141	
Increase in TRF assets:	$1.6 billion transferred from CLARA $2.0 billion from the POB issuance

[5] The Actuarial Recommended Contribution (ARC) is composed of: (1) the normal cost, which is the TRF liability for the current year and (2) the Unfunded Actuarial Accrued Liability (UAAL), which is the remaining unfunded liability from prior years that was not paid off by the POBs.

	$3.6 billion total increase in TRF assets
Increase in TRF liabilities:	**$2.6 billion from reinstatement of guaranteed COLA**
Net Impact of sHB 6141	**$1 billion decrease in TRF Unfunded Liability**

Table 9 shows the TRF assets and liabilities between 1994 and 2006. The funded ratio[6], which is the major benchmark of funding progress, has decreased from 68.1% as of the 6/30/00 valuation to 59.5% as of the 6/30/06 valuation. The net impact of sHB 6141 is to decrease the TRF's unfunded liability by $1 billion, which will increase the funded ratio to from 59.5% to 70%.

Table 9
($billions)
Connecticut Teachers' Retirement Fund: Schedule of Funding Progress

Date of Valuation (as of 6/30)	AAV[1]	AAL[2]	UAAL[3]	Funded Ratio
	a	b	b-a=c	a/b
1994	5.6	8.2	2.6	68.1%
1996	6.6	9.6	3.0	69.1%
1998	7.7	11.0	3.2	70.4%
2000	9.6	11.8	2.2	81.4%
2002	10.4	13.7	3.3	75.9%
2004	9.8	15.1	5.2	65.3%
2006	10.2	17.1	6.9	59.5%
sHB 6141 impact based on 2006	**13.8**	**19.7**	**5.9**	**70.0%**

[1] Actuarial Asset Value (not market value) of TRF assets provided by Gabriel Roder Smith & Co., the consulting actuary for the Teachers' Retirement System.
[2] Actuarial Accrued Liability provided by Gabriel Roder Smith & Co., the consulting actuary for the Teachers' Retirement System.
[3] Unfunded Actuarial Accrued Liability from prior years year provided by Gabriel Roder Smith & Co., the consulting actuary for the Teachers' Retirement System.

Full Funding of Annual ARC Payment Requirement

The bill deems appropriated the full amount required to fund the full ARC payment annually for the TRF for the 25-year term of the POBs. The fiscal impact of this requirement is that it: (1) precludes the possibility that the state will accumulate another unfunded liability due to underpayment of the ARC during the life of the POBs, and (2) will significantly improve the TRF's funded ratio over the long term.

Table 10 shows that General Fund appropriations were below the

recommended ARC between FY 93 and FY 05[7]. These shortfalls led to negative consequences for the TRF, including a significant lost investment opportunity and an increase in the TRF's unfunded liability. Requiring full ARC payments over 25 years will insure that the maximum funding is available to generate investment income.

Table 10
($millions)
Teachers' Retirement System: State Contribution History

Fiscal Year	ARC[1] (a)	General Fund Appropriation (b)	Shortfall (b)-(a)=c	Percentage Funded (b)/(a)
FY 93	299.6	111.6	(188.0)	37%
FY 94	145.8	124.3	(21.5)	85%
FY 95	154.0	132.5	(21.5)	86%
FY 96	164.7	140.0	(24.7)	85%
FY 97	180.1	147.9	(32.2)	82%
FY 98	211.0	179.4	(31.7)	85%
FY 99	221.6	188.3	(33.2)	85%
FY 00	240.5	204.4	(36.1)	85%
FY 01	252.5	214.7	(37.9)	85%
FY 02	210.7	204.5	(6.2)	97%
FY 03	214.7	179.8	(34.9)	84%
FY 04	270.5	185.3	(85.2)	69%
FY 05	281.4	185.3	(96.0)	66%
FY 06	396.2	396.2	0.0	100%
FY 07	412.1	412.1	0.0	100%

[1] Actuarial Required Contribution provided by Gabriel Roder Smith & Co., the consulting actuary for the Teachers' Retirement System (6/30/06 valuation).
[1] Actuarial valuation 6/30/06 Gabriel Roeder Smith & Co.

Credited Interest Rate – Voluntary Contributions

The bill sets the annual credited interest rate on voluntary TRS contributions to the same level as the TRF's actual return for the previous year. Currently, the Teacher's Retirement Board uses a 10-year actuarial smoothing method to calculate the interest rate. The consulting actuary for the TRF has indicated that this change has no fiscal impact to the TRF at the time of the change because over the long-term, the interest credited under either method is expected to be the same.

[6] The funded ratio is a percentage which, at a specific point in time, compares the TRF's assets with its liabilities (benefits earned by teachers as of that date).
[7] The state made the full ARC payment in FY 06 and FY 07 and the Governor has recommended full ARC funding in FY 08 ($518.5 million) and FY 09 ($539.3 million).

Assumptions Used for Analysis

The fiscal impact to the state is based on an analysis performed for the Office of the State Treasurer by Bear Stearns & Co. The analysis assumes the following:

Pension Obligation Bond (POB) Assumptions

1. The state will issue $2 billion in POBs. The bonds will be General Obligation (GO) bonds that pledge the full faith and credit of the General Fund (GF) and the debt service on the bonds will be a GF liability. The bonds will be issued in FY 08 for a term of 25 years at an interest rate of 5.6%.

2. The POBs will be issued as taxable bonds. Although the interest rate at which taxable GO bonds are issued is higher than the rate at which nontaxable GO bonds are issued, taxable bonds are permitted to earn a higher rate of return than the interest rate at which they are issued without triggering an arbitrage rebate penalty[8] from the federal government.

3. The Office of the State Treasurer will issue a portion of the GO bonds as capital appreciation bonds (CABs) but the amount is not known at this time.

4. The issuance of the $2 billion in taxable POBs will not have any adverse impact[9] in the financial markets on the normal issuance of taxable and nontaxable GO bonds or Special Tax Obligation (STO) bonds for other state purposes.

5. The POB covenant will require the state to make the full actuarially required contribution (ARC) payments to the TRF

[8] Federal law imposes an arbitrage rebate penalty on states that invest the proceeds of tax-exempt bonds in securities that produce higher rates of return than the tax-exempt bonds.
[9] Adverse impacts could include lowering the state's credit rating or increasing the interest rate at which the state is able to issue GO or STO bonds.

during each year of the 25-year life of the bonds.

6. The estimated cost of issuance ($11 million) will be included in the total amount of POBs issued. Although the bill permits the POB issuance to include up to 2 years of interest on the bonds, the estimates do not include this cost.

7. The POBs will be exempted from the statutory cap on GO bonds (CGS Section 3-21).

Teachers' Retirement Fund (TRF) Assumptions

1. The $2 billion in proceeds from the POB sale will be invested in the TRF in FY 08.

2. The average rate of return on the funds in the TRF will be 8.5% between FY 08 and FY 32 (a period equal to the 25-year term of the bonds). It should be noted that 8.5% is the actuarial earnings assumption for the TRF.

3. The Cost of Living Adjustment Reserve Account (CLARA) will be eliminated as a separate account and the resources of CLARA will be added into TRF in FY 08.

4. A cost of living adjustment (COLA) will be guaranteed to teachers who retire on or after September 1, 1992 and will be paid from TRF.

Other Assumptions

1. A total of $100 million in FY 07 budget surplus will be appropriated to cover some of the costs to the General Fund in FY 08 and FY 09.

The Out Years

The net impact of the bill over 25 years is projected to be a savings of $2.76 billion in General Fund contributions to the Teachers

Retirement Fund.

OLR Bill Analysis
sHB 6141

AN ACT CONCERNING ADEQUATE FUNDING OF THE TEACHERS' RETIREMENT SYSTEM.

SUMMARY:

The bill authorizes enough state general obligation bonds to fund (1) $2 billion of the unfunded liability of the Teachers' Retirement System (TRS), (2) the cost of issuing the bonds, and (3) up to two years of interest on the bonds. It exempts the bonds from the state's debt limit. The maximum bond term is 30 years.

For each fiscal year in which the bonds are outstanding, the bill automatically appropriates the actuarially required annual state contribution to the Teacher's Retirement Fund (TRF) and allows the state to reduce these annual contributions only if it protects bondholders' rights in another way.

The bill makes all TRS benefits contractual for all TRS members while the bonds are outstanding, thus barring the state from unilaterally reducing benefits during that time. Certain specified TRS benefits are already contractual for active teachers who were vested in the system on October 1, 2003 or who become vested or accumulate 10 years of credited service after that date.

The bill eliminates the cost of living adjustment reserve account (CLARA) within the TRF and credits all CLARA's assets to the TRF. CLARA is currently used to fund annual cost of living adjustments (COLAs) for TRS members who retire on or after September 1, 1992 and their surviving beneficiaries. Under current law, CLARA is funded by allocating to it any total annual TRF returns above 11.5%.

The bill guarantees these retirees an annual COLA by eliminating a provision that bars TRS from paying them a COLA in any year that TRS actuaries determine CLARA does not have enough money to pay for it. The bill also reduces promised retirement COLAs for members who join TRS on or after July 1, 2007.

The bill sets the annual credited interest rate on voluntary TRS contributions members make at the same level as the TRF's actual return for the previous year rather than at "substantially" that level, thus allowing voluntary contribution accounts to reflect short-term fluctuations in TRF investments. It does not change the credited interest rate for mandatory contributions.

EFFECTIVE DATE: July 1, 2007

TRS BONDS

Bond Authorization

The bill authorizes the State Bond Commission to allocate the amount of state general obligation bonds, with a maximum term of 30 years, needed to fund the bill's purposes. The state must use the bond proceeds to pay $2 billion of the TRS' unfunded liability plus the bond issuance costs and up to two years of bond interest. The TRS unfunded liability is the system's actuarially determined pension liability for service before the determination date minus the assets in the TRF.

Before the bond commission can authorize the bonds, it must receive:

1. a signed request for a bond authorization by, or on behalf of, the Office of Policy and Management secretary containing any terms and conditions the commission requires and

2. a written determination from the secretary and the state treasurer that issuing the bonds is in the state's best interest.

Exemption from State Debt Limit

The bill exempts the bonds from the state's statutory debt limit and

from the certifications related to it. State law limits the total amount of General Fund-supported state debt the General Assembly can authorize to 1.6 times the net General Fund tax receipts for the fiscal year of the authorization. Before the General Assembly may pass any bonding bill, the state treasurer must certify that it will not cause the state to exceed the debt ceiling. A similar certification is required before the bond commission can authorize any new bonds (CGS § 3-21.)

Bond Proceeds and Net Premium

The bill requires the bond proceeds and any investment earnings on them, minus the cost of issuance, to be deposited in the TRF. It requires the treasurer to invest the bond proceeds, less their issuance costs, according to the statutory requirements for investing state trust funds. The proceeds must be used, along with TRS member contributions and General Assembly appropriations, to pay teacher retirement benefits.

The bill requires any net premium the state realizes on the sale of the bonds to be used to pay debt service on them. (A premium is an amount a bond purchaser pays for a bond that exceeds its face value. Buyers typically pay a premium to receive an above-market interest rate on a bond.)

State Commitments to Bondholders

For each fiscal year in which any TRS bonds or any bonds refunding them remain outstanding, the bill establishes an automatic General Fund appropriation for the state's required annual contribution to the TRF, as determined by the fund actuaries and certified by the Teachers' Retirement Board and state comptroller. The annual appropriation must be allotted quarterly on July 15, October, 1, January 1, and April 1.

The bill sets the state's required contribution at the amount determined for each year by the TRS actuaries in their required actuarial evaluations of the fund, starting with contributions certified for the FY 07-09 biennium on December 1, 2006. It requires the

Teachers' Retirement Board to update their evaluation and the state's certified contribution for the second year of each budget biennium by December 1, of the preceding year.

The bill promises, and authorizes the state treasurer to promise bondholders, that the General Assembly will not pass any law to diminish the state's required contributions until the bonds are paid off unless the state makes other provisions to protect bondholders' rights. The bill makes this promise contingent on (1) the TRS actuaries certifying the state's annual contributions as required by law and (2) completion of annual actuarial evaluations the bill requires.

TEACHER BENEFITS UNDER TRS

While the TRS bonds are outstanding, the bill makes all TRS benefits for all members contractual in nature. By making benefits contractual, the bill bars the state from unilaterally diminishing TRS benefits during the bond term.

Certain TRS benefits are already contractual for active teachers who were vested in TRS as of October 1, 2003 or who vest or accumulate 10 years of service in TRS on or after that date. Current law bars the General Assembly from diminishing statutory TRS retirement provisions concerning credited service; retirement and survivors' benefits eligibility; benefit formulas, payment schedules, and cost of living allowances; death and survivors' benefits; and disability benefits. The bill extends the contractual benefits to cover provisions relating to voluntary contributions, benefit payment options, and reemployment benefits, among others. It also extends the contractual provision to all TRS members, including retired teachers and active teachers not yet vested. (Presumably, the latter's contractual benefits would not be effective until they vested in TRS.)

Both the current law and the bill exclude retired teachers' health coverage and health coverage contributions and annual state contributions to the TRF from the TRS contractual benefits.

COST OF LIVING ADJUSTMENTS

Cost of Living Adjustment Reserve Account (CLARA)

Under current law, COLAs for TRS members who retire on or after September 1, 1992 and their surviving beneficiaries are paid from the CLARA account, which is a separate TRF account. CLARA is funded by allocating to it any part of the total return on the fund's pension assets for the preceding year that exceeds 11.5%. On May 1 each year, the fund actuaries determine how much of a COLA the CLARA account can support. If they determine there is not enough money, no COLA is paid. The bill eliminates both CLARA and the no-COLA possibility. When CLARA's elimination takes effect on July 1, 2007, the bill transfers its assets to the TRF.

COLAs for TRS Members Who Retire on or After 9/1/92

Under current law, TRS members who retire on or after September 1, 1992 and their surviving beneficiaries are eligible for an annual benefit COLA if the TRS actuaries determine the CLARA account can pay for it. If there is not enough money to pay the full COLAs, they must be proportionately reduced or eliminated.

The bill repeals the actuarial certification and proportional COLA reduction requirements and thus guarantees annual COLAs for these retirees. It keeps the existing COLA calculation for these members, which is a COLA equal to the Social Security benefit COLA, but no more than 6%, or if the total return on the TRF's assets was less than 8.5% in the previous year, no more than 1.5%.

COLAs for New TRS Members

The bill reduces promised retirement COLAs for members who join TRS on or after July 1, 2007. For these members, TRS retirement COLAs will be the Social Security benefit COLA subject to a three-tier maximum based on annual TRF earnings. If total fund returns for the preceding year are less than 8.5%, the maximum COLA is 1%; if returns are between 8.5% and 11.5%, the maximum COLA is 3%; and if returns are more than 11.5%, the maximum COLA is 5%.

INTEREST ON VOLUNTARY MEMBER CONTRIBUTIONS

TRS members contribute 6% of their salaries to fund the TRS plus 1.25% of salary to fund retiree health coverage. Together, these contributions are referred to as "mandatory contributions." Members may also make additional voluntary contributions to the TRS.

The Teachers' Retirement Board must pay credited interest on both mandatory and voluntary contributions held in TRF. Current law sets the interest rate on both types of contributions at "substantially" the return the fund earns. In practice, the board uses a 10-year actuarial smoothing method to calculate the interest rate. This method reduces volatility in annual interest payments. The bill instead ties the credited interest rate for voluntary contributions at the fund's actual rate of return for the previous fiscal year. Thus, under the bill, voluntary accounts could experience losses if the TRF has a negative short-term return.

The bill requires the state treasurer to certify the fund's annual return to the Teachers' Retirement Board by September 1 following the close of the fiscal year. As under current law, interest on voluntary contributions is applied to each member's balance as of the previous June 30.

By law, members may withdraw their voluntary contributions, plus credited interest, once during their service under the TRS. Upon retirement, they can opt to receive their voluntary contributions, plus credited interest, either in a lump sum or in the form of an actuarially equivalent life annuity.

BACKGROUND

Teachers' Retirement System

The TRS is a state-funded, defined benefit retirement system for professional employees working in Connecticut public schools. It covers employees who (1) hold positions requiring a teaching certificate or permit issued by the State Board of Education, (2) hold the appropriate certification for their position, and (3) are employed at least half-time. It offers normal, proratable, and early retirement after a

10-year vesting period. TRS members are not covered by Social Security for their TRS service, and TRS benefits are not coordinated with Social Security. The TRS is administered by a 12-member Teachers' Retirement Board.

COMMITTEE ACTION

Appropriations Committee

Joint Favorable Change of Reference
Yea 46 Nay 0 (04/10/2007)

Finance, Revenue and Bonding Committee

Joint Favorable Substitute
Yea 52 Nay 1 (04/17/2007)