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THE VOICE OF LOCAL GOVERNMENT

TESTIMONY

of the

CONNECTICUT CONFERENCE OF MUNICIPALITIES

to the

PLANNING AND DEVELOPMENT COMMITTEE

Municipal Pensions Options

March 10, 2010

The Connecticut Conference of Municipalities is Connecticut's statewide association of towns and cities and the voice of local government - your partners in governing Connecticut. Our members represent over 90% of Connecticut's population. We appreciate this opportunity to testify on the following bill of interest to towns and cities:

CCM <u>supports</u> R.B. 5031, "An Act Reducing Costs to Municipalities". Contained in this bill is a proposal that would provide for *municipal pension reform through development of an alternative benefits plan.*

Municipalities, like the State, face a burgeoning problem of paying for post-employment benefits for retired employees. In many municipalities, municipal pension funds are underfunded. GASB accounting rules have created further problems for non-pension retirement benefits.

According to one study, there are at least 24 municipal entities with more than 40% underfunded pensions; an additional 23 with pensions between 30%-40% underfunded.

This is not a problem that can be ignored. A new state program should be a "defined contribution" plan into which new hires can be enrolled. With a defined contribution plan, municipalities would better be able to control costs and do financial planning. We do not lightly say that benefits for employees should be reduced – but it is no longer sustainable to have a population of citizens with defined contribution plans paying taxes to support one class of employees with traditional defined benefit plans.

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Municipalities need options and tools with which to approach these problems.

This proposal – to find a lower-cost state alternative pension system for new hires – promises long-term savings and a reduction in the chronic problem of underfunding.

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If you have any questions, please call Ron Thomas or Gian-Carl Casa of CCM, at (203) 498-3000.

Attachment

The Municipal Pension Crisis
Connecticut Law Tribune
Monday, March 08, 2010

Printed for

The Municipal Pension Crisis

Connecticut Magazine ran a recent article outlining the impending crisis in municipal pension funds across the state. Nationwide, public pension funds have dropped from being roughly 85 percent funded to approximately 65 percent funded in the last two years. Pennsylvania recently enacted a "loan fund" and modifications to their investment standards because certain municipalities had become "severely distressed" as their funding had approached 50 percent.

The Connecticut Office of Policy Management's Report on Municipal Fiscal Indicators shows that most municipalities are experiencing falling investment returns and tax revenues while their debt and employee life expectancy are rising. Combined with Governmental Accounting Standards Board (GASB) Statement 45, which requires public disclosure of the financial liabilities and costs public employers face with regard to retiree medical benefits plans and similar "other post employment benefits," many towns and cities are facing a mountain of unfunded liability and a potential downgrade in their bond rating.

The state pension funds are also significantly underfunded. However, unlike many of the municipal funds, Connecticut Treasurer Denise Nappier's investment management group has done a commendable job during the financial meltdown preserving and investing the monies entrusted to it. The state funds have lost less than 14 percent of net asset value compared to losses exceeding 30 percent in many of the municipal funds. In no small part, this success can be attributed to the development, maintenance and regular re-calibration of a comprehensive Investment Policy Statement that created an asset allocation guide, proxy policy, and performance evaluation tool for each of the 14 funds under its care.

A similar policy of analytical rigor and fiscal forethought was proposed to municipalities by the State Task Force on Municipal Retirement Systems in 1997. The task force's report is still posted on OPM's web site and is good advice today as it was then. However, few public officials have utilized the state's guidance and tools to determine whether the taxpayers can actually afford the benefits already promised, leaving them without long-term solutions to this accelerating calamity. Many municipalities and fire districts hold down their tax rate by using actuarial assumptions regarding investment return, retirement rates, life expectancy and lump sum withdrawals that result in significantly understating the accrued liability.

Municipal officials should conduct an audit based on the State Task Force's template to determine the current funding status of their pension and health care funds, evaluate their alternatives and map a strategy.

The audit should tell policymakers, taxpayers, and employee groups the following: 1) Does the public employer's tax and revenue base combined with their investment returns have sufficient growth capacity to afford current benefits? 2) Could continuation of the status quo result in a lower bond rating or higher borrowing costs? 3) Will increased pension costs "crowd out" capacity to fund other post-employment benefits? 4) Are the benefits now awarded to employees appropriate and necessary for the employer to continue, in light of local labor market conditions? 5) Is total compensation both fair and affordable, and thus sustainable?

If changes are necessary, the state's Investment Policy Statement is a good place to start to address investment behavior. Among the common ways to raise revenue and cut spending are: creating a second lesser tier of benefits for incoming employees; increasing employee contributions; increasing vesting periods and eligibility requirements; and scaling back the benefits to be earned for future service by current employees.

Finally, municipalities must consider whether their present plan's unfunded liabilities could be better funded through debt financing at a lower cost than the investment returns available in the capital markets. In addition to an objective analysis of these issues, an audit report should include a strategic summary that outlines a viable direction for future benefits policy actions, plan designs and financing options.

Connecticut municipalities face a massive challenge armed with the substantial advantage of a road map containing directions to more viable and sustainable financing, investment and plan structures. Let's hope they use it. •