# PRELIMINARY FISCAL NOTE

## Appropriations Committee
## Meeting

February 23, 2012

**OFFICE OF FISCAL ANALYSIS**
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**SR 4 and HR 4 Resolution Proposing Approval of a Collective Bargaining Agreement Between the State Employees Bargaining Agent Coalition and the State of Connecticut**

The resolution proposes approval of an Agreement between the State of Connecticut and the State Employees Bargaining Agent Coalition (SEBAC). The Agreement provides for additional pension funding above the present level by eliminating two negotiated adjustments (attributed to SEBAC IV and V) which have been used to reduce the state's annual required contribution (ARC). Approval of the resolution will result in an additional estimated FY 13 cost to the State Employees Retirement Contributions accounts of $85.2 million in the General Fund and $12.7 million in the Transportation Fund.[1] Funding for the increased FY 13 cost is not included in the Original FY 13 Budget, however it is included in the Governor's Revised FY 13 Budget. These additional costs will gradually decrease beginning in FY 15 until a savings is achieved beginning in FY 24. The net impact over the current 20-year amortization period is a savings of approximately $1.95 billion (General & Transportation Funds).

The table below outlines the additional annual costs as well as savings for the next twenty years as projected by the pension fund's actuaries. It should be noted that future actuarial estimates may differ significantly from these projections if actual plan experience differs from current assumptions.

[1] Under the Agreement, the gross increase in the ARC would be $123.4 million. After accounting for various other fund recoveries and reimbursements, the State's actual additional contribution to the FY 13 ARC would be $97.9 million (GF & TF).

**Fiscal Impact of Eliminating SEBAC IV & V Adjustments**

| Fiscal Year | Gross ARC *Before* Adjustments Eliminated | Gross ARC *After* Adjustments Eliminated | Additional Gross ARC Cost / (Savings) | Est. GF Portion (Net *After Recoveries & Reimbursements*) | Est. TF Portion (Net *After Recoveries & Reimbursements*) |
|---|---|---|---|---|---|
| FY 12 | 926,372,000 | n/a | n/a | n/a | n/a |
| FY 13 | 936,259,000 | 1,059,652,000 | 123,393,000 | 85,249,879 | 12,738,106 |
| FY 14 | 1,027,068,000 | 1,155,397,000 | 128,329,000 | 88,660,068 | 13,247,659 |
| FY 15 | 1,117,719,000 | 1,240,960,000 | 123,241,000 | 85,144,865 | 12,722,415 |
| FY 16 | 1,164,885,000 | 1,281,119,000 | 116,234,000 | 80,303,862 | 11,999,068 |
| FY 17 | 1,212,660,000 | 1,320,433,000 | 107,773,000 | 74,458,318 | 11,125,622 |
| FY 18 | 1,278,280,000 | 1,375,970,000 | 97,690,000 | 67,492,165 | 10,084,734 |
| FY 19 | 1,348,789,000 | 1,434,510,000 | 85,721,000 | 59,223,010 | 8,849,150 |
| FY 20 | 1,423,758,000 | 1,495,294,000 | 71,536,000 | 49,422,863 | 7,384,804 |
| FY 21 | 1,504,520,000 | 1,559,242,000 | 54,722,000 | 37,806,390 | 5,649,062 |
| FY 22 | 1,592,131,000 | 1,626,885,000 | 34,754,000 | 24,010,878 | 3,587,725 |
| FY 23 | 1,689,498,000 | 1,700,446,000 | 10,948,000 | 7,563,765 | 1,130,184 |
| FY 24 | 1,796,992,000 | 1,779,380,000 | (17,612,000) | (12,167,796) | (1,818,122) |
| FY 25 | 1,917,250,000 | 1,865,056,000 | (52,194,000) | (36,059,843) | (5,388,091) |
| FY 26 | 2,051,206,000 | 1,956,576,000 | (94,630,000) | (65,378,069) | (9,768,844) |
| FY 27 | 2,204,265,000 | 2,056,543,000 | (147,722,000) | (102,058,323) | (15,249,638) |
| FY 28 | 2,383,154,000 | 2,167,078,000 | (216,076,000) | (149,282,803) | (22,305,958) |
| FY 29 | 2,601,547,000 | 2,293,456,000 | (308,091,000) | (212,854,218) | (31,804,850) |
| FY 30 | 2,887,435,000 | 2,445,821,000 | (441,614,000) | (305,102,722) | (45,588,696) |
| FY 31 | 3,318,167,000 | 2,652,680,000 | (665,487,000) | (459,772,324) | (68,699,554) |
| FY 32 | 4,498,776,000 | 3,034,334,000 | (1,464,442,000) | (1,011,755,153) | (151,177,277) |
| **Net Budget Impact of Negotiated Agreement** | | | | **(1,695,095,188)** | **(253,282,501)** |

*Source: Office of Policy and Management – Cost Estimate of Negotiated Agreement Dated 2/3/2012 and Actuarial Estimate dated 1/20/2012.*

### *Background*

The State Employees Retirement System (SERS) provides for a defined benefit plan for its members, whereby retirees receive a fixed pension benefit that is determined by tier membership, the number of years the employee worked, and his or her final average salary. The State is statutorily required to fund SERS on an actuarial reserve basis.[1] Nevertheless, superseding collective bargaining agreements and "notwithstanding" language in budgets over the years has allowed funding lower than

[1] Per CGS 5-156a.

the required level.

Actuarial valuations are prepared at least every two years to determine the state's annual required contribution (ARC).[1] The ARC is comprised of the normal ("current service") cost plus the portion of the unfunded actuarial liability (past unpaid bill) amortized for that year, and if paid on a consistent basis, should provide sufficient resources to fund both the normal cost for each year and pay off the unfunded liability at the end of the amortization period. However, under interpretations of SEBAC IV and V, negotiated by the State and the coalition in 1995 and 1997, respectively, the ARC is further reduced each year.[2] Approval of the resolution would eliminate these additional ARC reductions as of FY 13.

The SEBAC IV and V adjustments both reduce the State's unfunded liability payment as a result of how the pension fund's assets are treated. Per the SEBAC IV Memorandum of Agreement, the difference between the market value of assets and the actuarial value of assets as of June 30, 1995 was amortized on a level percent of pay basis over 36 years. The resulting amount was used to reduce the amount of the State's contribution towards the unfunded liability. In a similar fashion to the SEBAC IV adjustment, SEBAC V "captured" market value investment gains as of June 30, 1996. This gain was also amortized and used to reduce the State's contribution towards the unfunded liability.

Since the SEBAC IV and V Agreements, it is unclear if these provisions have been interpreted correctly in terms of applying these reductions to the ARC after 1996.[3] According to the State's pension plan actuaries, the impact of these adjustments has been to exacerbate the back-loading of the amortization schedule already inherent in the level percent-of-payroll method, which leads to further growth each year in the ARC and delays in improving the plan's funded ratio.[4] The State's estimated ARC for FY 32 is currently a "balloon payment" of $4.5 billion.

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[1] Based on the most recent valuation, the State's ARC was determined to be $926.4 million for FY 12. After accounting for various recoveries and reimbursements, the State's actual FY 12 contribution to the ARC is $743.8 million.

[2] It should be noted that SEBAC IV and V were not the first instances of the state and SEBAC agreeing to reduce ARC contributions - both SEBAC II and III also had negotiated contribution levels, however these reductions were time-limited.

[3] Source: Post Employment Benefits Commission Final Report, page 21

[4] Funded ratio, the ratio of the pension plan's assets to its liabilities, is one indicator of the fiscal strength of a pension fund's ability to meet its obligations to its members. As of the latest SERS valuation, the plan is funded at 48%.