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Written Testimony
Comptroller Kevin Lembo
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Concerning
S.R. No. 7 & H.R. No 8: Resolutions Proposing Approval of an Agreement Between the State of Connecticut and the State Employees Bargaining Agent Coalition

Good afternoon Senator Osten, Representative Walker, Senator Formica, Representative Ziobron, and Members of the Appropriations Committee.

Thank you for the opportunity to submit this written testimony in support of an agreement to reform Connecticut's pension payment system and establish predictability in the state budget.

Connecticut's unfunded pension liabilities are a crushing debt that increasingly crowd out other state budget priorities and remain a top concern for businesses when deciding whether to invest here and hire more workers.

The agreement reached by Gov. Dannel P. Malloy and the State Employees Bargaining Agent Coalition attempts to stabilize ballooning costs over the next 16 years.

When the agreement was announced, some hailed it as a panacea and others derided it as ineffective, but this issue is too complex for soundbites. It demands our critical thinking and attention to facts, including how we got here in the first place.

In 1992, the state created a plan to pay its unfunded pension obligations by 2032. The payment plan was flat and predictable — like a fixed-rate mortgage. In the mid-1990s, however — when the state enjoyed consistent surpluses — government decision-makers at that time negotiated an agreement to lower the annual pension fund contributions. But this meant that payments would sharply increase in the distant future, like a balloon mortgage.

That distant future is now. The balloon payments have arrived and are scheduled to get precipitously bigger each year. The cost of paying for benefits earned this year is slightly under $300 million. When combined with the cost of those decades of deferred payments and other shortfalls, however, the cost for us in 2016 was more than $1.5 billion.

That annual payment could grow from $1.5 billion to nearly $6 billion in a single year by 2032.

Compounding the problem is that Connecticut has, for many years, relied on a rosy assumption about how much the pension fund's investments will grow each year (8 percent, when a lower assumption is more realistic and responsible).

The agreement by Gov. Malloy and SEBAC includes a great deal of the components that both I and Treasurer Nappier advocated for. It replaces the sharp and volatile rising balloon payments with flat, stable and predictable annual contributions. It achieves this by lengthening the payment plan for a portion of the unfunded liabilities, allowing us to pay slightly more in the beginning, but maintaining a manageable amount over the years, rather than face consistently sharp rising payments.

It also adopts a more conservative and realistic assumption about how much the pension fund investments will perform in the financial markets each year.

To those who like to evoke the age-old "kicking-the-can" metaphor, a sound bite that resonates when out of context, I urge you to consider this: The can has already been kicked down the road and now we're staring down the barrel of a $6-billion balloon payment. It's simply unsustainable and irresponsible for us to ignore it. The responsible solution, for our generation and the next, is to create a responsible and disciplined flat payment plan.

A 6.9-percent investment return assumption – aside from being far lower than the current 8 percent – is one of the lowest in the country for a state pension plan, according to the National Association of State Retirement Administrators (the average is 7.62 percent). Moreover, the State Employees Retirement Commission sets the investment return assumption and has the ability to make future adjustment should the 6.9 percent prove unachievable.

By lowering the state's investment growth assumptions – the state is acknowledging reality and more honestly reporting the true scope of our unfunded liabilities.

This agreement has raised questions about benefit design. For example, should overtime be included in pension calculations – and should employees contribute more to the pension plan? These are fair questions, but I strongly caution against rejecting this agreement on the basis that it doesn't address benefit design. If the state eliminated the pension system, and every Connecticut employee left tomorrow, the state would still owe these billions in unfunded pension costs. Why oppose this agreement when a separate conversation can be had about benefit design?

And let's be honest: Rejecting this agreement would also fail to address benefit design – while also eliminating any chance for pension payment reform. Rejecting this agreement would be the worst case scenario.

The credit rating agencies endorse this action (Moody's called it a "credit positive"). The business community has supported this agreement and demanded action. I urge support for this agreement to steer the state from financial devastation, and to establish predictability that businesses and residents deserve.