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Testimony submitted to the Connecticut General Assembly Appropriations Committee
Hearing on the agreement between the State of Connecticut and SEBAC
by Greg Mennis, Director, The Pew Charitable Trusts

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Co-Chairs Formica, Osten, and Walker, and Members of the Committee,

Thank you for the opportunity to provide testimony this morning on the agreement between the State of Connecticut and the State Employees Bargaining Agent Coalition, regarding changes to pension funding for the Connecticut State Employees Retirement System (SERS). In my comments this morning, I will touch briefly on Pew's research on public sector pensions, outline our support for the agreement being discussed today, and address specific questions that policymakers have raised on this new pension funding policy.

By way of background, the Pew Charitable Trusts is a non-profit research and policy organization that is committed to informing the public and improving public policy with non-partisan, rigorous, fact-based research. Pew supports over 40 projects in the field of government performance, covering a diverse set of issues ranging from public safety concerns to the effectiveness of state tax incentives to the fiscal health of public pensions.

The Public Sector Retirement Systems project produces 50-state research and provides technical assistance to policymakers in states and cities in their efforts to make public retirement systems more sustainable and secure. We approach our work with a clear understanding that there is no one size fits all solution, and endeavor to provide objective, data- driven analysis that is tailored to the specific circumstances in each jurisdiction where we work.

Connecticut has one of the most fiscally challenged pension systems in the country. As of 2015, the state reports assets on hand equal to only 49%[1] of promised benefits – a funded ratio that ranks Connecticut 47th across the fifty states. The root causes of the state's fiscal position have been well documented. Connecticut was late to adopt an adequate policy to pre-fund pension promises by the 1980's; consequently, did not fully realize the benefit of the bull run of the stock market in the 1990's; and, like all states, saw unfunded liabilities grow during the volatile financial markets of the 2000's.

The state has made a demonstrated effort to make full actuarial contributions into its' pension systems for over a decade now, and Connecticut scores in the middle of the pack on net amortization – the metric that we use to assess contribution adequacy.[2] But unfunded liabilities have continued to grow, pension costs have doubled as a share of state resources over the past decade, and the state's

[1] State Employees, Teachers, and Judicial Retirement Systems on a combined basis
[2] "The State Pension Funding Gap: 2014," Pew Charitable Trusts, August 2016, http://www.pewtrusts.org/~/media/assets/2016/08/thestatepensionfundinggap2014.pdf

assumed rates of return on plan investments are above the US average. Informed by this research, Pew worked with Comptroller Lembo and his staff in developing the proposal to improve pension funding policy that was issued one year ago, and helped to shape the agreement being presented today.

Overall, we support the revised pension funding policy as a positive step forward to improve the fiscal health of the State Employees Retirement System, and to make pension costs more predictable for taxpayers over time. This support is based largely on two factors. First, lowering the plan's assumed rate of return from 8.0% to 6.9% will reduce the risk of unplanned costs from investment return shortfalls going forward. This change will also align the state's assumptions more closely with recent expert forecasts[3], while moving Connecticut from having one of the highest assumed rates of return among state worker plans in the country, to one of the lowest.

Perhaps more importantly, the new policy is projected to increase funding into the state pension system in the near term. An increase of more than half a billion dollars compared to current policy over the next five years, and more than a billion dollars over 10 years - a substantial level of payment against the current $16.5 billion in pension debt. We evaluate funding policy impacts over five to 10 years to ensure that payments are not back loaded, which can compound costs. And in Connecticut, the five year time horizon is also meaningful in that we expect the funding policy to be reviewed in that time frame under current law.[4]

The primary concern that has been voiced on the agreement is around the potential cost of extending the amortization schedule –the time horizon for the payment plan that actuaries project will be required to achieve fully funded status. However, our analysis indicates that if policymakers agree that lowering the assumed rate of return to 6.9% is prudent, legislators face a choice: to either increase annual contributions to SERS by approximately $300 million each year beginning with next year's budget, or extend the payment plan to recognize the impact of the lower assumed rate of return on plan investments. Note also that both Moody's and Standard & Poor's have identified similar concerns but also issued net positive reviews of the proposed funding policy.

The agreement is not, of course, a complete solution to the fiscal challenges on pensions facing Connecticut going forward. It will still require decades of fiscal discipline to fully fund the state's pension obligations – including increases averaging 7% over the next five years. Policymakers will also need to be attentive to the impact of the next economic downturn on the fiscal health of the state's pension system and budget. The agreement does, however, represent a strong and positive step forward. Thank you for inviting us and we welcome your questions.

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[3] "2015 Report on State Retirement Systems: Funding Levels and Asset Allocation," Wilshire Consulting, February 2, 2015, https://www.wilshire.com/media/38890/wilshire_2015_state_funding_report.pdf

[4] Please see "Pew's Analysis of Changes to Contribution Policy for the Connecticut State Employees' Retirement System" dated 12/22/16 for a further discussion of these analyses and our recommendation to regularly re-evaluate the state's pension funding policy.