OFFICE OF LEGISLATIVE RESEARCH
Objective Research for Connecticut's Legislature

ResearchReport

Teachers' Retirement System Financial Stabilization Law

By: John D. Moran, Principal Analyst
December 23, 2019 | 2019-R-0289

Issue

Provide a summary of the changes PA 19-117 (herein after referred to as "the act") made to the Teachers' Retirement System (TRS), including the creation of the special capital reserve fund for the outstanding Connecticut Teachers' Retirement bonds.

Special Capital Reserve Fund and Related Changes for the Teachers' Retirement Bonds

The act, §§ 82-90, established the teachers' retirement bonds special capital reserve fund ("reserve fund") and appropriated $380.9 million for deposit in the fund. The reserve fund is assurance that if the state were to fail to make its full annual required payment to retirement fund bondholders, then the state treasurer would direct a transfer of money from the reserve fund to complete the payment. If that occurred, the act further requires that Connecticut Lottery Corporation funds be diverted to bring the reserve fund back up to its required amount.

The act states that the reserve fund's purpose is to provide adequate protection for the pension obligation bond (POB) holders by further securing the payment of the bond principal and interest. It also states that the reserve fund provides this adequate protection. The reserve fund money is pledged for payment on the bonds. The state issued $2.276 billion in POBs in 2008 to help cover some of the Teachers' Retirement System's (TRS) unfunded liability.

The act appropriated $380.9 million from the state's FY 19 General Fund to deposit in the reserve fund contingent upon the Teachers' Retirement Board (TRB) approving changes in (1) the investment return assumption for the Teachers' Retirement Fund and (2) the credited interest percentage for member accounts.

The act also changes the amortization method for TRS unfunded liability from a level-percentage of payroll to a level-dollar amortization. This change will take place over five years. The act also allows for a new 30-year amortization period for the unfunded accrued actuarial liability (UAAL) as of June 30, 2018.

The act also includes related changes such as a pledge to bondholders and specific actions required of the state treasurer and the TRB.

Treasurer's Duties (§ 82 (a) & (b))

The act requires the treasurer to enter an agreement with a trust company or bank (i.e., fund trustee) to hold the reserve fund money in an account or accounts. The agreement must be in accordance with the provisions of the act, including the parts related to the TRS and the lottery corporation.

The treasurer must certify to the governor, the TRB, and the lottery corporation president when the amount on deposit in the reserve fund first reaches or exceeds the required minimum capital reserve. "Required minimum capital reserve" is the highest remaining annual payment, including principal and interest, for the POBs. That amount is $380.9 million. Deputy Treasurer Linda Savitsky made the certification on June 27, 2019, that the $380.9 million had been deposited with U.S. Bank National Association.

If the state has not paid the principal or interest due on the POBs, the act requires the treasurer to direct the fund trustee to transfer the necessary amount from the reserve fund to pay the outstanding amount. No money can be withdrawn from the reserve fund that will reduce its balance below the required minimum, except to make a payment on the principal or interest of the POBs.

The treasurer may direct the trustee to remit to the treasurer, for deposit in the General Fund, any amount in excess of the required minimum capital reserve.

Reserve Fund Uses and Termination (§ 82(b) & (e))

Under the act, the money held in the reserve fund must be used solely for:

1. purchase of the POBs,
2. POBs interest payment,

3. bond principal payment as the POBs become due by reason of maturity or sinking fund redemption, and

4. redemption premium payment required when the POBs are redeemed prior to maturity.

Under the act, the reserve fund terminates:

1. when the POBs have been fully repaid,

2. if certain specified funds are deposited in an irrevocable trust on behalf of the bondholders in an amount that is sufficient to pay (a) the bond's principal and interest when due and (b) any redemption premium due when the bonds are redeemed prior to maturity,

3. if the amount of the annual required contribution to the fund for the TRS is determined in accordance with the TRS actuarial standards at the time the bonds were issued, or

4. if the TRB fails to approve the credited interest percentage for member accounts and return assumption in accordance with the act's provisions.

When the reserve fund terminates, the treasurer must direct that any balance be transferred to the Budget Reserve Fund (i.e., Rainy Day Fund).

Investment and Reinvestment (§ 82(f))

While money is in the reserve fund, the act allows the treasurer to order the funds to be invested or reinvested in obligations, securities, or investments as permitted under the laws governing general obligation bonds or participation certificates in the Short Term Investment Fund.

Pledge to Bondholders (§ 82(a) & (g))

Under the act, the reserve fund must be held in trust, separate and apart from other state funds, for the benefit of the bondholders. As such, it prohibits fund deposits from being commingled with other state funds. The act specifies that the state has no claim in the reserve fund except as the act allows.

In accordance with the act, the state pledges to the holders of POBs and any related refunding bonds, that the state will not limit or alter their rights or reduce the transfer or deposit of money into the reserve fund. However, the act makes exceptions when (1) all the bonds are fully paid or (2) other provisions for payment of the bonds are made and the amount of the fund's annual required TRS contribution is determined in accordance with the TRS actuarial standards at the time the bonds were issued. Additionally, the act provides that none of its provisions preclude limitations, alterations, or reductions if adequate protection of the bondholders is made by law.

Under the act, the state's pledge to use the reserve fund to pay the bonds is valid and binding from the time the pledge is made. Accordingly, the lien of this pledge is valid and binding against all parties having any claims against the state in tort, contract, or otherwise, regardless of whether the parties have notice of the claims. The act states that such a lien has priority over all other liens.

Connecticut Lottery Corporation (CLC) Duties (§§ 82(e), 83, 84 & 85)

Under the act, if the level of the fund falls below the required minimum capital reserve amount, the state lottery corporation must pay the reserve fund trustee the amount that the corporation would have otherwise transferred to the General Fund.

The act creates an additional purpose for the CLC by requiring it to make payments to the reserve fund trustee. It also authorizes transfers from the lottery fund to the reserve fund. Under prior law, the CLC transferred to the General Fund, on a weekly basis, any balance of the lottery fund that exceeded the needs of the corporation for paying lottery prizes and meeting operating expenses and reserves. Under the act, if the amount in the reserve fund is below the required minimum capital reserve, the CLC must instead pay the amount it would have transferred to the General Fund to the reserve fund trustee for deposit in the reserve fund. If the corporation makes a transfer to the General Fund at a time when the reserve fund is below the required minimum capital reserve, the transfer amount will be deemed appropriated from the General Fund to the reserve fund.

The act also requires that the amount payable from the CLC to the reserve fund be sufficient for the payment of the principal and interest due on the bonds the reserve fund secures.

Required TRB Actions (§ 89)

The act specifies that no money may be deposited in the reserve fund, and that other provisions of the act will not take effect, until the TRB approves the following:

1. the change in the credited interest-percentage for members' accounts from the current actuarially determined amount up to 4% annually and
2. a return assumption rate of 6.9% (the prior rate was 8% as previously set by TRB).

The TRB approved these changes at its June 5, 2019, meeting, according to the meeting minutes (see [June 5 meeting minutes]).

Furthermore, if the board approves the above items, by July 1, 2019, it must, (1) request a revised actuarial valuation for FYs 20 and 21 and (2) certify to the General Assembly the revised actuarially determined employer contribution (ADEC) for FYs 20 and 21. According to the same meeting minutes, the TRB formally requested a new valuation. The revised valuation was presented to the TRB at a special meeting on June 28 where the board voted to approve the new valuation that used the new interest-percentage for members' accounts and the new return assumption rate (see June 28 meeting minutes).

TRS Amortization Method Change and New Schedule (§§ 86 & 88)

The act transitions the amortization method for the TRS from a level-percentage of payroll to a level-dollar amortization over a five-year period.

The act replaces the prior 40-year amortization schedule with a new 30-year schedule for the UAAL, determined as of June 30, 2018, and allows future gains or losses to be amortized over new 25-year periods. It eliminates the requirement that the ADEC be based on members paying a 6% contribution, thus allowing the ADEC to be calculated based on the actual member contribution (7%), as is standard practice in such valuations.

The act allows the General Assembly to reduce the ADEC only if the governor declares an emergency or extraordinary circumstance and at least three-fifths of the members of each chamber vote for a reduction for the biennium of the declared emergency. This mirrors language in the POB covenant.

The act also requires the treasurer to deposit the General Assembly appropriation for the ADEC into the Teachers' Retirement Fund in quarterly allotments on July 15, October 1, January 1, and April 1 each year.

JM:kl