PENSION FUNDING REFORM

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Policy Director
Background

- SERS funding policy is collectively bargained
- Certain aspects of the funding policy are written into collective bargaining agreements including the:
  - amortization method, amortization period, and actuarial cost method
- Other actuarial assumption are set by the State Employee Retirement Commission – the policy board that oversees SERS including the:
  - long-term investment return, inflation rates, longevity tables, and other actuarial assumptions
- Catalyst for Action:
  - OPM and the Governor commissioned the Center for Retirement Research at Boston College to conduct a forensic study on the state’s two largest pension plans – SERS and TRS – to determine the cause of their low funded ratios
  - The report, released last fall, determined funding reform was needed to avoid potentially unsustainable growth in future ARC payments, while meeting long-term obligations.
  - Following the release of the report Governor’s Office, the Comptroller and the Treasurer all put forward proposals to put SERS funding back on a sustainable path
  - In the 2016 State of the State address the Governor called for OPM, OSC and OTT to meet and develop funding policy alternatives for consideration
- This spring the three offices collaboratively evaluated a variety of alternative funding policies to help inform labor and management negotiations
- Reform options are now being negotiated between Labor and Management representatives
In this Presentation

• This presentation will:
  1. Highlight the need for reform
  2. Review the guiding principles and goals of reform
  3. Review the components of an alternative funding policy that addresses those guiding principles and goals
  4. Discuss the benefits of such an alternative funding policy
  5. Identify the primary challenges to adoption of such an alternative funding policy
SERS Pension Payments are Growing as a Percentage of State Expenditures

<table>
<thead>
<tr>
<th>FY</th>
<th>ARC as % of GF Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>2.50%</td>
</tr>
<tr>
<td>2016</td>
<td>6.30%</td>
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</tbody>
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In 2016 total General Fund spending increased 2.9%; 80% of the increase was attributable to increases in debt service and SERS pension payments*

*Source: Comptroller’s year end letter to the Governor
ARC Payments to Continue to Rise

Total State Contribution

CAGR FY16 – FY32 5.1%
Actual Experience Could be Significantly Worse

• SERS does not have a strong track record of meeting actuarial assumptions*
  • $4.1 billion in experience losses between 1985 – 2014
  • $1.3 billion in investment return losses between 1985 – 2014
• The preliminary 2016 experience study shows additional experience losses

Sensitivity Analysis – Current Funding Policy

Connecticut SERS
30-Year Projection of State Contribution to SERS
8% Investment Return Assumption (5.0% Real Return; 3.0% Price Inflation)
Forward Bootstrap Hypothetical Returns over 30 year period
Baseline Results - PUC Cost Method with Level Percentage of Payroll Amortization Method
Amortization Period Closed over 16 year period

![Graph showing projections of state contributions for Connecticut SERS over 30 years with different assumptions and scenarios.](image-url)
Seeking a Solution

• Principles for evaluation
  • Fully fund pension promises
  • Reduce the volatility of future ARC payments
  • Make ARC payments more sustainable as a share of the state budget
  • Protect the state’s bond rating
  • Ensure positive amortization - ARC payments sufficient to reduce unfunded liability
  • Avoid legal ambiguity – Use generally accepted actuarial principles and funding methodologies
## Assumptions and Methods – Current vs. Alternative

<table>
<thead>
<tr>
<th></th>
<th>Current Assumptions and Methods</th>
<th>Alternative Assumptions and Methods</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Long-Term Investment Rate of Return Assumption</strong></td>
<td>8.00%</td>
<td>7.00%</td>
</tr>
<tr>
<td><strong>Amortization Method</strong></td>
<td>Level Percent of Payroll</td>
<td>Level Dollar</td>
</tr>
<tr>
<td><strong>Actuarial Cost Method</strong></td>
<td>Projected Unit Credit (PUC)</td>
<td>Entry Age Normal (EAN)</td>
</tr>
<tr>
<td><strong>Amortization Period Remaining as of June 30, 2015</strong></td>
<td>17 Years</td>
<td>25 Years*</td>
</tr>
<tr>
<td><strong>Price Inflation Assumption</strong></td>
<td>3.00%</td>
<td>2.50%**</td>
</tr>
<tr>
<td><strong>Real Rate of Return Assumption</strong></td>
<td>5.00%</td>
<td>4.50%</td>
</tr>
<tr>
<td><strong>Amortization of Gains and Losses</strong></td>
<td>Over Remaining Years of Amortization Period</td>
<td>Layered Amortization - Closed 25 Year Periods</td>
</tr>
</tbody>
</table>

*Projected Unfunded Accrued Liability (UAL) of Statutory Bases (page 42 of 2014 valuation report) is $4.2 Billion as of June 30, 2015 is amortized over a closed 17 year period from 2015 Valuation. Remaining Balance of UAL of $10.6 Billion as of June 30, 2015 (Experience Bases) plus $3.3 Billion due to change in discount rate from 8% to 7% amortized over a closed 25 year period from 2015 Valuation.

**Although Price Inflation assumed to be 2.5%, the Cost-of-Living Adjustment (COLA) assumptions kept the same.
Comparison

Total State Contribution (ARC)

- Current
- Alternative Option
Benefits of Alternative Funding Policy

- ARC payments are more predictable and stable
- ARC payments reduce annually as percent of expenditures when actuarial assumptions are met
- More conservative actuarial assumptions reduce the risk of future actuarial losses
Connecticut SERS
30-Year Projection of State Contribution to SERS
8% Investment Return Assumption (5.0% Real Return; 3.0% Price Inflation)
Forward Bootstrap Hypothetical Returns over 30 year period
Baseline Results - PUC Cost Method with Level Percentage of Payroll Amortization Method
Amortization Period Closed over 16 year period

Sensitivity Analysis – Current Funding Policy
Sensitivity Analysis – Alternative Option

Connecticut SERS
30-Year Projection of State Contribution to SERS
7% Investment Return Assumption (4.5% Real Return; 2.5% Price Inflation)
Forward Bootstrap Hypothetical Returns over 30 year period
Level Dollar Amortization Method Graded over 3-year period
Restatement of UAL - Statutory base over 17 years; Experience bases over 25 years

2024 Funding Ratios
6.00% - 46.9%
7.11% - 67.4%
8.00% - 58.8%

2034 Funding Ratios
6.00% - 70.8%
7.11% - 79.3%
8.00% - 100.0%

2044 Funding Ratios
6.00% - 82.0%
7.11% - 100.0%
8.00% - 100.0%

Valuation Year

Millions

$0 $500 $1,000 $1,500 $2,000 $2,500 $3,000

Bootstrap 1 - 7.11% Assumption
Bootstrap 2 - 6% Assumption
Bootstrap 3 - 8% Assumption
Primary Challenge to Reform

Ramping up payments in short-term

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Current ARC Schedule</th>
<th>Alternative Option</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>1,652,306</td>
<td>1,637,449</td>
<td>-14,857</td>
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<tr>
<td>2019</td>
<td>1,712,681</td>
<td>1,841,893</td>
<td>129,212</td>
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<tr>
<td>2020</td>
<td>1,775,581</td>
<td>2,056,031</td>
<td>280,450</td>
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<tr>
<td>2021</td>
<td>1,856,053</td>
<td>2,085,431</td>
<td>229,378</td>
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<td>2022</td>
<td>1,927,014</td>
<td>2,088,521</td>
<td>161,507</td>
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<td>2023</td>
<td>2,009,159</td>
<td>2,090,296</td>
<td>81,137</td>
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<tr>
<td>2024</td>
<td>2,096,663</td>
<td>2,092,036</td>
<td>-4,627</td>
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</table>
Comparing Apples to Apples

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Current ARC Schedule - 7% Return</th>
<th>Alternative Option</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>1,917,139</td>
<td>1,637,449</td>
<td>-279,690</td>
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<tr>
<td>2019</td>
<td>1,987,109</td>
<td>1,841,893</td>
<td>-145,216</td>
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<tr>
<td>2020</td>
<td>2,059,130</td>
<td>2,056,031</td>
<td>-3,099</td>
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<td>2021</td>
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<td>2,085,431</td>
<td>-63,122</td>
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<td>2022</td>
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<td>2,088,521</td>
<td>-140,641</td>
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<tr>
<td>2023</td>
<td>2,323,078</td>
<td>2,090,296</td>
<td>-232,782</td>
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<td>2024</td>
<td>2,423,340</td>
<td>2,092,036</td>
<td>-331,304</td>
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Questions