Commission on Enhancing Agency Outcomes
Connecticut Retirement and Pension Summary

Benefit payments. Annual retirement benefit payments currently total more than $1.2 billion annually. (These do not include cost-of-living adjustments – two since FY 08).

Table 1. Current retirees: When retired, Average Salary and Total Benefit Payments and COLA Adj.				
When Retired	Number 6/30/08	Average Retirement Salary	Total $ Annually (000) FY 08	COLA on Pension: Annual wage adjust. on all retirement wage
Pre-1980	2,750	$15,710	$43,202	5%
1980-1997	20,480	$26,855	$549,998	3%
1997 and after	14,863	$30,564	$454,278	Choice of 3% or formula below, except after June 30, 1999 formula below
2009 (RIP)	3,898	$45,700	$168,861 (FY 09)	Formula -- 2.5%-6% depending on CPI
Total	**41,991**	**$28,966**	**$1,216,339**	
Sources: FY 2008 SERS Actuarial Report and the Office of State Comptroller for 2009 RIP Data				

Overall, Connecticut's state retiree benefits are generous. Comparison Nationally 2008[1]: **Private Sector -- $13,222 Public Sector --$24,147**

When Hired	# of Current Employees	Average Salary (June 2008)	Tier	Employee Contribution (Pre-tax)	Age to Retire (Generally)
Pre-1984	353	$98,028	Tier I – Hazardous Duty	4% to Social Security Taxable Wage Base plus 5% earnings above	Any -20 years of service
Pre -1984	6,512	$84,987	Tier 1 (plan B or C)	2% to 5% of earnings depending on Social Security participation	55
1984-1997	5,400	$80,282	Tier II Hazardous	4%	Any (20 years of service)
1984 -1997	16,924	$71,670	Tier II	0%	60
1997 and after	5,692	$59,516	Tier II –A Hazardous	5%	Any -20 years of service
1997 and after	18,315	$50,623	Tier II-A	2%	62
Not date-driven; primarily in higher education	9,800	Unknown	Alternative Retirement Plan	5%	
Sources: 2008 Milliman Actuarial Report of SERS and other Office of State Comptroller Information					

[1] Employee Benefits Research Institute. Figure 5 Mean Annual Income from Pensions and Annuities in Constant 2008 Dollars for Population Over 50. May 2010 Notes, Vol. 31. No 5., p. 17

Retiree Health Care Costs. In FY 09, actual expenditures for retiree health care costs totaled almost **$435 million**, **and estimated to be more than $542 million in FY 10.** The table below outlines the monthly premiums for current retiree health care benefits. The retiree health plans have the same coverage, co-pays and benefit structure as those for active employees. By comparison, monthly premiums for active employees are generally between $105 and $220 for subscriber+1, depending on plan chosen. (Approximated since payments are made each pay period; most expensive plan which is about $500 a month, closed after 2009 SEBAC agreement).

Table II – CT Retiree Health Insurance Benefits	
When Retired	Post-retirement healthcare premiums (monthly)
Pre-1980	$0
1980-1997	$0
1997-1999	$0 for most plans
1999 and after	Depends on plan -- $0 for many plans –others vary typically about $30 a month for 2 not on Medicare

Until 2009, all payments for retiree health care were made on a pay-as-you go basis. However, as part of the 2009 SEBAC agreement, employees with less than five years of state service must pay 3 percent of their salaries for 10 years into a fund for their post-retirement health care (refundable if the employee leaves state service before 10 years.)

Comparison on Contributions to Pension: Only 7 states have required employee contributions equal to Connecticut's current 2% or below; five of those states require no contributions from employees.

ISSUES

Unfunded liability or legacy costs: The employer contribution rate for SERS is currently **24.96%** of state payroll, or **$944 million**. However, of that, 15.96% of payroll ($603m) is funding the unfunded portion of current retirees (because of prior unfunded or underfunding pension payments), while about **9% of payroll ($341m)** is funding for current employees. This does not include payments for retiree health care benefits, which are currently on a pay-as-you-go basis, and in FY 10 is about **$542 million** annually for current retirees and their dependents. Also, this does not include funding for employees in the alternative retirement system – which includes approximately **9,800 employees – and in FY 10 the state's contribution was $33.4 million.**

It is important to note that only about 1/3 of the current annual retirement contribution (ARC) is for current employees, while 2/3 of the ARC goes for retirees. However, the unfunded liability may continue to grow if underestimating the payments required to pay for future retirees occurs. This may be likely for a few reasons:

- Connecticut's actuarial estimates of investment income are among the highest of any state's pension plan – 8.25%. Only six other states had the same estimate; only three had higher (8.5%) compared to about 7-7.5% nationwide[2]; without investment returns that closely match estimates, the unfunded liability will grow.
- Connecticut's 2008 funding ratio[3] was slightly less than 52%, meaning that only a little more than half of estimated obligations (at present value) were being funded – only Illinois was less at 46%; Since the economic downturn, the actuarial assessment of the funding ratio is now in the mid-40% range;

[2] Wisconsin Legislative Council. 2008 Comparative Study of Major Public Employee Retirement Systems.
[3] Funding ratio is ratio of two numbers – the value of benefits earned compared to the value of assets to support the benefits

- Assumptions on wage inflation (4%) may be too low. According to the June 2008 actuarial valuation report, the compensation for active SERS had increased from $3,107.9 billion in FY 06 to $3,497.4 billion in FY 08, an increase of 12.5% in two years alone. If state employee wage inflation is looked at over a longer period, (between FY 00 and FY 10) state payroll has grown at a greater rate than 4 percent (compounded) a year. Given the payroll amounts, even a small fraction of a percent difference can be important.

- The contribution levels from current employees cited above, the relatively optimistic interest rate assumptions, and low wage inflation assumptions raise questions as to whether the state retirement system is chronically underfunded, not just because of prior liability but also because current funding does not adequately cover the current and future benefit obligations.

In a recent New York Times article, Connecticut was cited as one of four states whose pension fund could run out of money within a decade unless changes are made.[4] While the study's conclusions are being refuted by the National Association of State Retirement Directors, it seems clear that Connecticut's pension fund and its future financial stability is a matter of great concern.

SPECIFIC CONCERNS WITH CONNECTICUT'S SERS PENSION PLAN

A great number of current employees (about 14,000 TIER II post-RIP) make no contributions to their pension plan. While Tier II-A employees do contribute, the 2% is also low compared to other states. Based on estimated payroll data of about $1 billion for Tier II, $10 million could be generated for every 1% of employee contributions (prior to investment returns).

There is no cap on the retirement salary a retiree can be paid -- either by amount or by percentage of final average salary. (CT Teachers' Retirement has a cap of 75% of FAS). Connecticut does have a cap in the calculation of the FAS, which is no one year of the three-year calculation can be more than 130% of either of the other two. The two factors may contribute to retirement salaries increasing.
The average retirement salary for the 2009 RIP is over $45,000 as shown in Table 1. This is more than $15,000 greater than the average of those retiring after 1997 but before June 2008 (date of last actuarial valuation).

The COLA adjustments are generous compared to other states. Connecticut's COLA adjustment is a minimum of 2.5% (or 60% of CPI up to a cap of 6%) of total retirement salary annually. Since 2000, the 2.5% threshold has always been greater than 60% of CPI, and in 2010, the CPI actually decreased (- 0.4). Most states do not have a minimum % COLA, but rather use CPI with a max. Massachusetts, Rhode Island, and New York also cap the amount of retirement income the COLA applies to (e.g. the first $15,000) rather than the total amount. Other states have a waiting period before a retiree begins receiving a COLA adjustment; Connecticut does not. On the other hand, some states (e.g., MA and NY) exempt retirement benefits from state income tax, while Connecticut does not.

While COLA adjustments of 1% above or below CPI may not seem considerable, on annual retirement payouts of $1.2 billion, 1% is $12 million. Further, when there is a minimum COLA, in a year like 2010 when CPI actually declined, the COLA payments of $30 million are adding to the base payout – in the payout year and for years to come -- but for non-existent inflation. Further, Social Security recipients have not received a COLA increase in two years. Most active Connecticut state employees did not receive a COLA adjustment in FY 09 and many did not for either FY 09 or FY 10.

[4] Article refers to a study by Joshua Rauh, PhD Northwestern University

The percent of active members in hazardous duty is increasing. Overall the percent of employees in hazardous duty employment as of June 2008 was **11,445, which was 21.5%** of SERS active membership. This is in contrast with **3,306 hazardous duty retirees,** which **is only 13.7%** of retirees. This may have implications for future retirement costs and liability: longer time in retirement; COLAs over a longer period, and more difficult final average salary to predict because of overtime.

Further, the average annual benefit paid in FY 08 to regular **SERS retirees ages 60 to 64 was $36,467,** while the average benefit paid to those **hazardous duty retirees** in the same age category, the average annual benefit was **$47,273**, a more **than $10,000 difference**.[5] The difference in annual average benefits between the two groups is even greater at younger ages, and the average annual retirement payment difference between the two groups overall was more than **$15,000**.

Other than increasing employee contributions, actual retirement provisions for hazardous duty employees have not changed over time: 20 years to retire at half the FAS which is the final average salary[6]; method of calculating the FAS which includes overtime[7]. Studies and reports have found that the use of overtime can be a salary "spiking" issue.

EFFORTS AT REFORM

Pursuant to Executive Order 38, a Commission on State Post-Employment Benefits was established in February 2010. The commission completed its work, issuing a final report on October 28, 2010. The Executive Summary of the report is attached. The full report can be accessed at

www.ct.gov./opm/lib/opm/secretary/opeb

[5] Summary Statistics (p.47) from FY 2008 SERS Valuation Report
[6] Final average salary for SERS is 3 highest-paid years, including overtime and longevity
[7] New York Times, July 7, 2010. *Cuomo Finds Pattern of Workers' Inflating Pensions*

Executive Summary

Governor M. Jodi Rell established the State Post-Employment Benefits Commission (the Commission) through Executive Order #38. Although Governor Rell recognized that pension and other post employment benefits (OPEB) consisting mainly of retiree health insurance, play an important role in attracting and maintaining a skilled and capable work force, she highlighted the growing impacts of the unfunded liabilities and costs related to these plans on the State's budget and finances. The Governor charged the Commission with delivering a report that:

- Identifies the amount and extent of unfunded liabilities for pensions and other post-employment benefits;
- Compares and evaluates the advantages and disadvantages of various approaches for addressing unfunded pension liabilities and post-employment benefits; and
- Proposes short and long-term plans for addressing unfunded pension liabilities and post-employment benefits.

The Commission reviewed actuarial valuations, collective bargaining agreements and other information regarding Connecticut's retirement systems as well as research reports and articles addressing these issues. The Commission also obtained actuarial estimates of liabilities and various approaches to how they may be addressed.

Liabilities and Costs Related to Connecticut's Retirement Systems

The State's pension plans include the Teachers Retirement System, the Judicial Retirement System, and the State Employees Retirement System (SERS) all of which are defined benefit plans. SERS covers the majority state employees and retirees as well as members of the General Assembly, constitutional officers and the Governor. Additionally, The State administers a defined contribution program for some higher education employees. The State also sponsors the State OPEB Plan (primarily health benefits) and the Retired Teacher Health Care Plan. The Commission focused on the SERS and State OPEB plans.

As of June 30, 2008, Connecticut's unfunded liability for SERS was $9.2 billion and $24.6 billion for OPEB, a total unfunded liability of $33.8 billion. Consider that Connecticut's current year general fund budget is $17.6 billion. Connecticut's 2008 funding ratio for its State-sponsored pension plans (plan assets as a percentage of plan liabilities), according to the Pew Center on the States, was the fifth lowest in the country. A November 2009 report by the Center for State and Local Government Excellence, indicated that Connecticut's unfunded OPEB liability was the third highest in the country

Connecticut's unfunded liabilities have lead to increasing costs consuming a growing percentage of state expenditures. In fiscal year 1992, the annual costs related to SERS, TRS and OPEB were 5.57 percent of state expenditures. They are projected to be 11.24 percent in the current fiscal year. If this trend continues, the percentages will grow to 13.7 percent in 2021 and almost 19 percent in 2032.

Causes of Unfunded Liability for SERS and State OPEB Plan

State Employee Retirement System (SERS)

The SERS plan has historically been underfunded, in part because, until the 1980's, it was funded on a pay-as-you-go basis. Indeed, the 2008 funding ratio of 51.9 percent is just slightly higher than the 1992 ratio of 51.4 percent, despite a decision to begin funding the Annual Required Contribution (ARC).

There are a number of reasons for a lack of progress with the SERS funding ratio. The Level Percent of Payroll method of calculating its ARC tends to have lower amortization amounts in the earlier years of the schedule. More importantly, interpretations applied to the 1995 and 1997 State and the State Employee Bargaining Agent Coalition agreements (SEBAC IV and V, respectively) have included annual reductions to the ARC. These reductions totaled over $105 million in fiscal year 2011. Moreover, reductions in the ARC payments of $314 million were included in the 2009 State and SEBAC agreement. The result is a heavy back-loading of the amortization schedule, resulting in a stagnant funding ratio and a growing annual ARC.

Some other reasons for a lack of funding progress include the 2009 and previous retirement incentive programs and the plan's assumed actuarial investment return. SERS, like most plans, was hurt by the severe market downturn in 2008, the main cause of the projected funding ratio decline to 46 percent as of June 30, 2010.

Historically, Connecticut has responded to concerns about unfunded liabilities by creating new tiers, as opposed to modifying existing tiers. SERS consists of three tiers: Tier I for those hired before July 1, 1984; Tier II for those hired from July 1, 1984 to June 30, 1997; and Tier IIA for those hired on or after July 1, 1997. According to the June 30, 2008 actuarial valuation, $14.3 billion of SERS total actuarial accrued liabilities of $19.2 billion are attributable to current retirees and Tier I active employees. This portion of the plan's liabilities would likely not be impacted by plan modifications given the legal issues involved.

Compared to other New England states, the annual payments as a percentage of final average salaries are lower for Tier II and IIA plans than the other states. The required employee contributions are lower in Connecticut as well. Connecticut's reductions in benefits related to early retirement are generally less than found in other New England states.

State Other Post Employment Benefit Plan (OPEB)

The challenge with OPEB for Connecticut and many other states is that the difference between the ARC and the pay-as-you-go amount (which is the amount Connecticut has been paying) is very difficult to fund from a budgetary standpoint. In 2008, the ARC was $1.65 billion. The actual amount paid for benefits was $.464 billion. Difficult as it is, continuing along the pay-as-you-go path will subject the state to continuing growth in these costs as a result of health inflation and a growing number of retirees. From fiscal year 1999-00 to 2008-09, these costs increased from $173.9 million to $452.0 million, or 11.2 percent per year.

As noted, Connecticut's OPEB liabilities are high compared to other states. The three main reasons for differences in per capita OPEB liability amounts are: 1) benefits levels and plan costs; 2) population covered; and 3) funding policy. In Connecticut, a high cost state, employees who work at least ten years are eligible to receive full comprehensive health care coverage for themselves and their dependants when they begin receiving retirement benefits, with 55 being the early retirement age for non-hazardous duty employees. The premium shares are minimal, ranging from zero to a maximum of three percent. Unlike pensions, once vested, the level of benefits received is not tied to the number of years of service. The Rule of 75 (years of service plus age) in the 2009 SEBAC agreement will delay when affected employees (those with less than ten years of service as of July 1, 2009) can begin receiving retiree health insurance.

In regard to funding, most states, like Connecticut have zero or few assets in their OPEB plans. The 2009 SEBAC agreement, however, included a provision that involved a 3 percent of salary employee contribution during the first ten years of service. These contributions are projected at $23 million in the current year. These contributions, by staying in the OPEB trust and not being used for current costs, will decrease the plan's actuarial liabilities and ARC.

Strategies for Consideration for Addressing Connecticut's Post Employment Benefit Liabilities and Costs

In light of the State's serious budgetary challenges over the next several years, and the pressure the growing costs of the State's retirement systems place on other budgetary needs, the Commission believes a number of approaches need to be considered to reduce the unfunded pension liabilities of the State. Consideration should be given to new funding strategies, financing alternatives, and plan design and benefit modifications. The issues and factors outlined in this report, among others, will need to be weighed when considering the strategies and approaches to be implemented in seeking to reduce these liabilities.

It is important to note that there are Commission members who did not agree with some of the strategies presented below in regard to the State pension and OPEB plans. Also, the Commission did not seek to prioritize these strategies. The main goal of this report has been to provide information and potential approaches to addressing these liabilities to policy-makers and stakeholders.

The State needs to develop a sound funding strategy for its retirement plans and have the fiscal discipline to carry it out. Timely analysis and multi-year actuarial projections are critical when policy makers are reviewing funding practices or making decisions impacting the plans. Policy makers need to question how a declining proportion of working-age citizens can fund Connecticut's unfunded liabilities for an increasing proportion of retirees.

Summary of Strategies for Consideration for SERS and OPEB

Short Term Plan

- **Pre-Fund OPEB**
- **Pay the ARC, and Eliminate Any Adjustments to Such.**
- **Increased Member Contributions.** The State and SEBAC should consider additional employee contributions for reinvestment in the plans (with a 1 percent increase totaling about $32 million), while the State should consider enacting a provision that would dedicate, for example, a portion of future surpluses for the plans.
- **Increasing the Retirement Age or Incentives to Retire Later.** The State and SEBAC should consider raising the retirement age for those in Tiers II and IIA and increasing reductions related to early retirements, with any savings to be reinvested into the plans. For SERS, the projected savings totaled $135 million related to these changes in the first year, savings would increase going forward.
- **Other Plan Design Strategies.** The State and SEBAC should consider plan modifications to SERS and OPEB, with any savings to be reinvested in the plans. In terms of OPEB, the changes for consideration include increased premium sharing and additional eligibility changes for employees moving directly to retirement from state service.
- **Service Delivery Changes.** It is also critical to continue slowing health care inflation through plan and service delivery changes, including through the implementation of medical homes and other initiatives. A one percent reduction in the annual health inflation below the actuary's assumed level would lower the calculated actuarial liability from $26.6 billion to $22.1 billion.

Long Term Plan

- **ARC and Funding Strategies.** The State should commit to a funding strategy targeting funding ratio benchmarks (e.g. 55 percent by 2018 for SERS), and consider establishing a "floor" below which ARC will not go below.
- **Actuarial Analysis and Projections.** The biennial actuarial valuations should reflect projections for liabilities and ARC amounts for all remaining years of the amortization schedule (not just two years).
- **Future Changes**. No action, such as a retirement incentive program or plan changes, should be enacted without a full actuarial analysis.

Considerable discussion was dedicated to the pros and cons of closing the defined benefit plan and replacing with a defined contribution arrangement for new employees; however, no consensus was reached as to whether this change would be beneficial to the State overall. Those on the Commission who opposed a defined contribution plan for new employees believe that such a plan would be more costly to the state and would not address the current unfunded liability problem, while providing lower and less secure retirement benefits to its employees. Those on the Commission who believed that a defined contribution plan should be considered expressed significant concern that the problems and

issues associated with the defined benefit plan could be perpetuated going forward at a growing cost to the State, especially if the recommendations in this report are ignored.

The challenge for the State will be to balance the need to increase the funding ratio of its pension and OPEB plans with the need to manage its overall budgetary needs. These increasing costs could lead to crowding out additional investments in education, infrastructure, health care, and in other critical areas.

It is the Commission's hope that this report will provide useful information to the Governor, other elected officials, and the stakeholders in adding to the understanding of the State's liabilities and costs related to its retirement system and in assessing the options available to address these issues.