PENSION FUNDING REFORM

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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

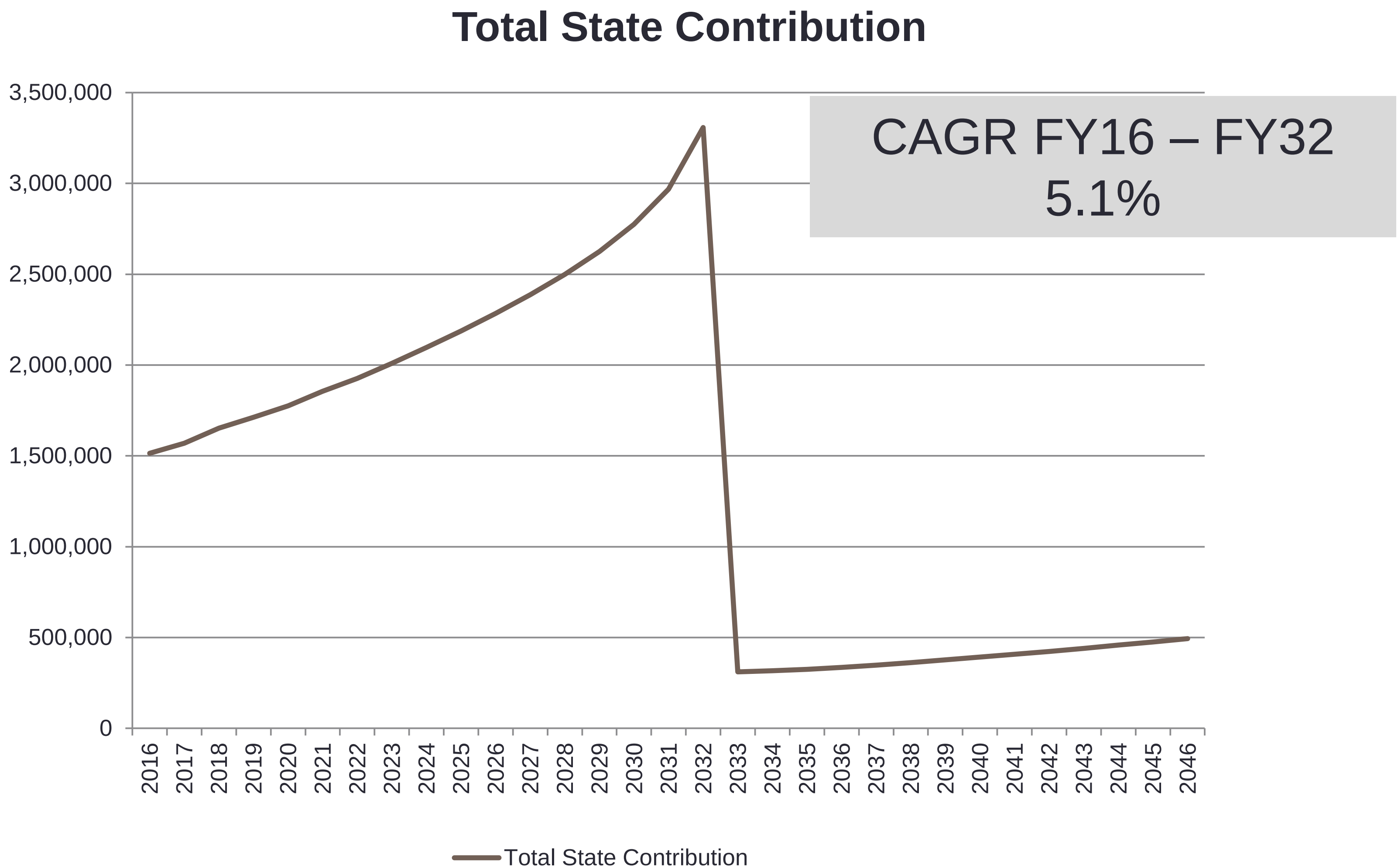
SERS Pension Payments are Growing as a Percentage of State Expenditures

FY	ARC as % of GF Expenditures
1996	2.50%
2016	6.30%

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

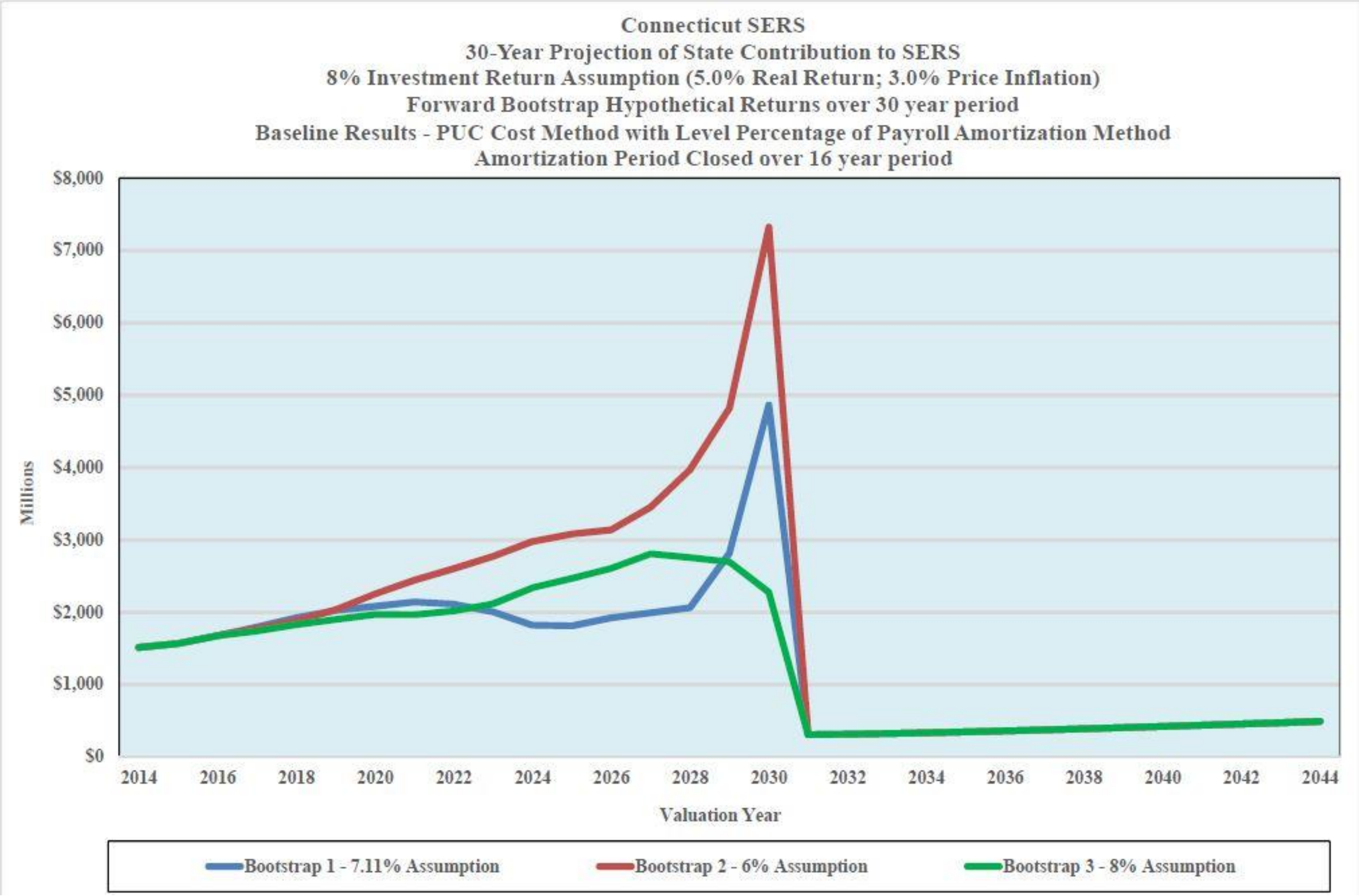


Actual Experience Could be Significantly Worse

- SERS does not have a strong track record of meeting actuarial assumptions*
  - $4.1 billion in experience losses between1985 – 2014
  - $1.3 billion in investment return losses between 1985 – 2014
- The preliminary 2016 experience study shows additional experience losses

Source: Jean-Pierre Aubry and Alicia Munnell. “Final Report On Connecticut’s State Employees Retirement System and Teachers’ Retirement System,” Center for Retirement Research. November 2015

Sensitivity Analysis – Current Funding Policy



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

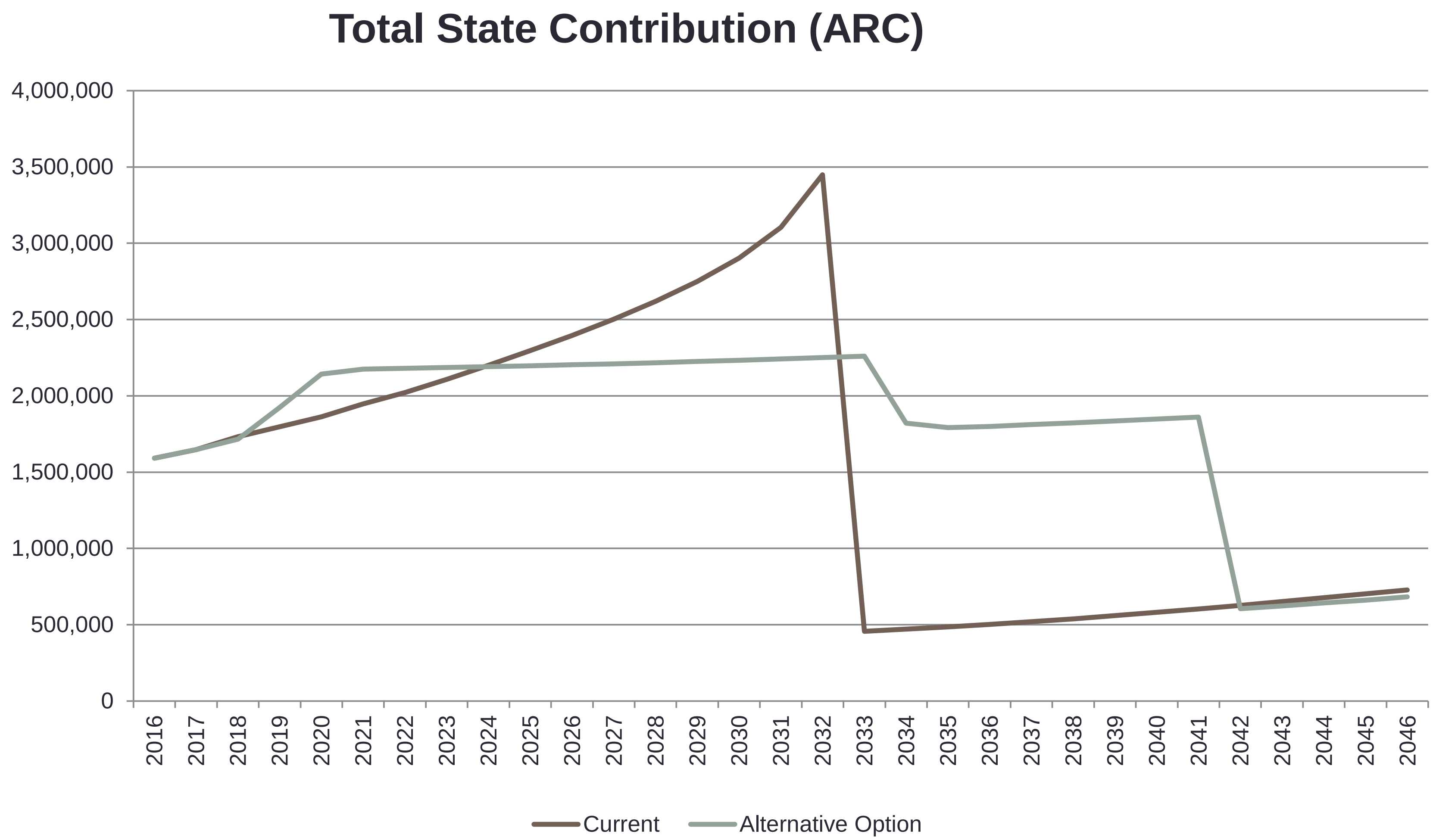
Assumptions and Methods – Current vs. Alternative

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

*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)
4,000,000
3,500,000
3,000,000
2,500,000
2,000,000
1,500,000
1,000,000
500,000
0
2016
2017
2018
2019
2020
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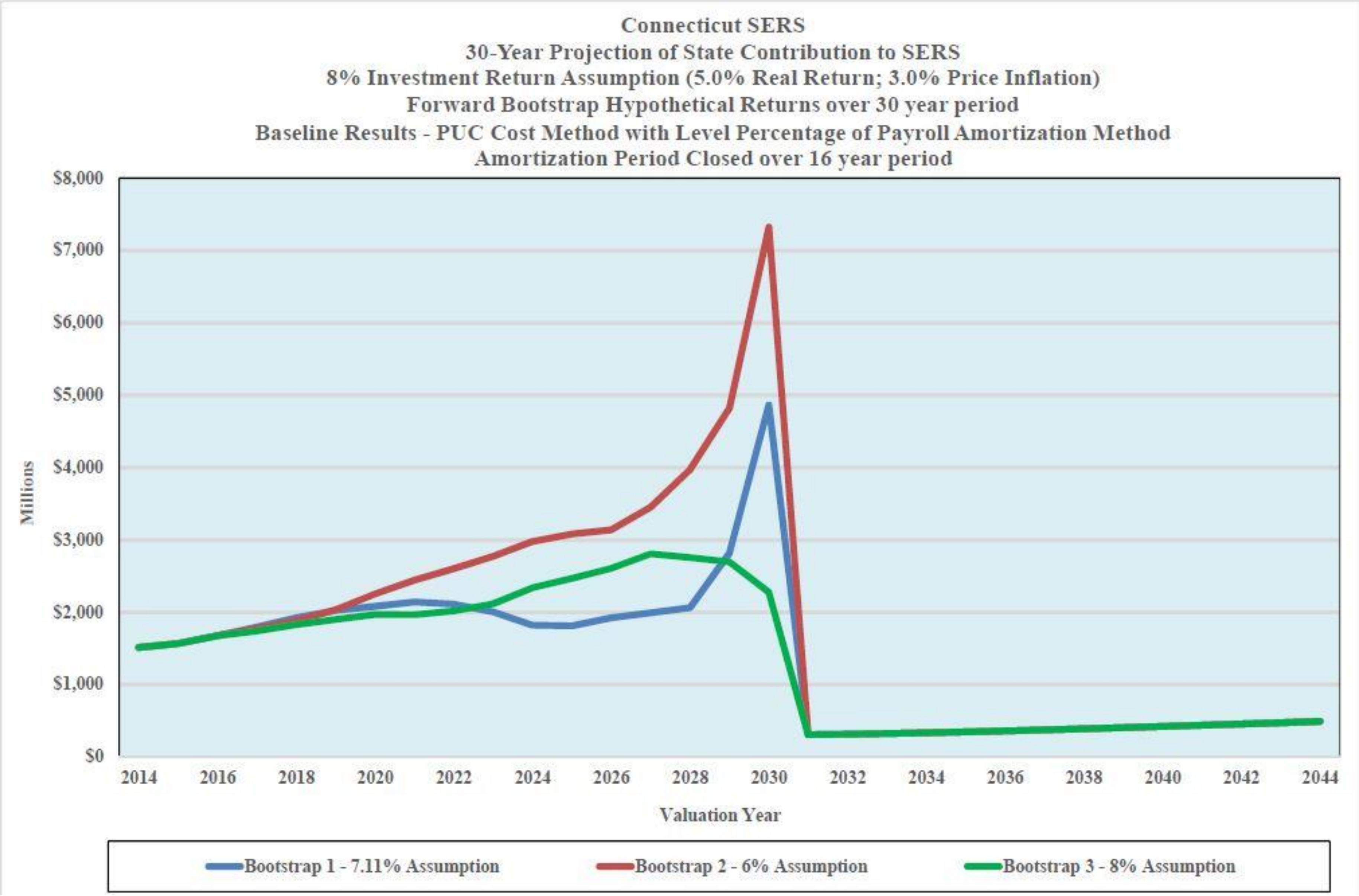
2043
2044
2045
2046
Current
Alternative Option

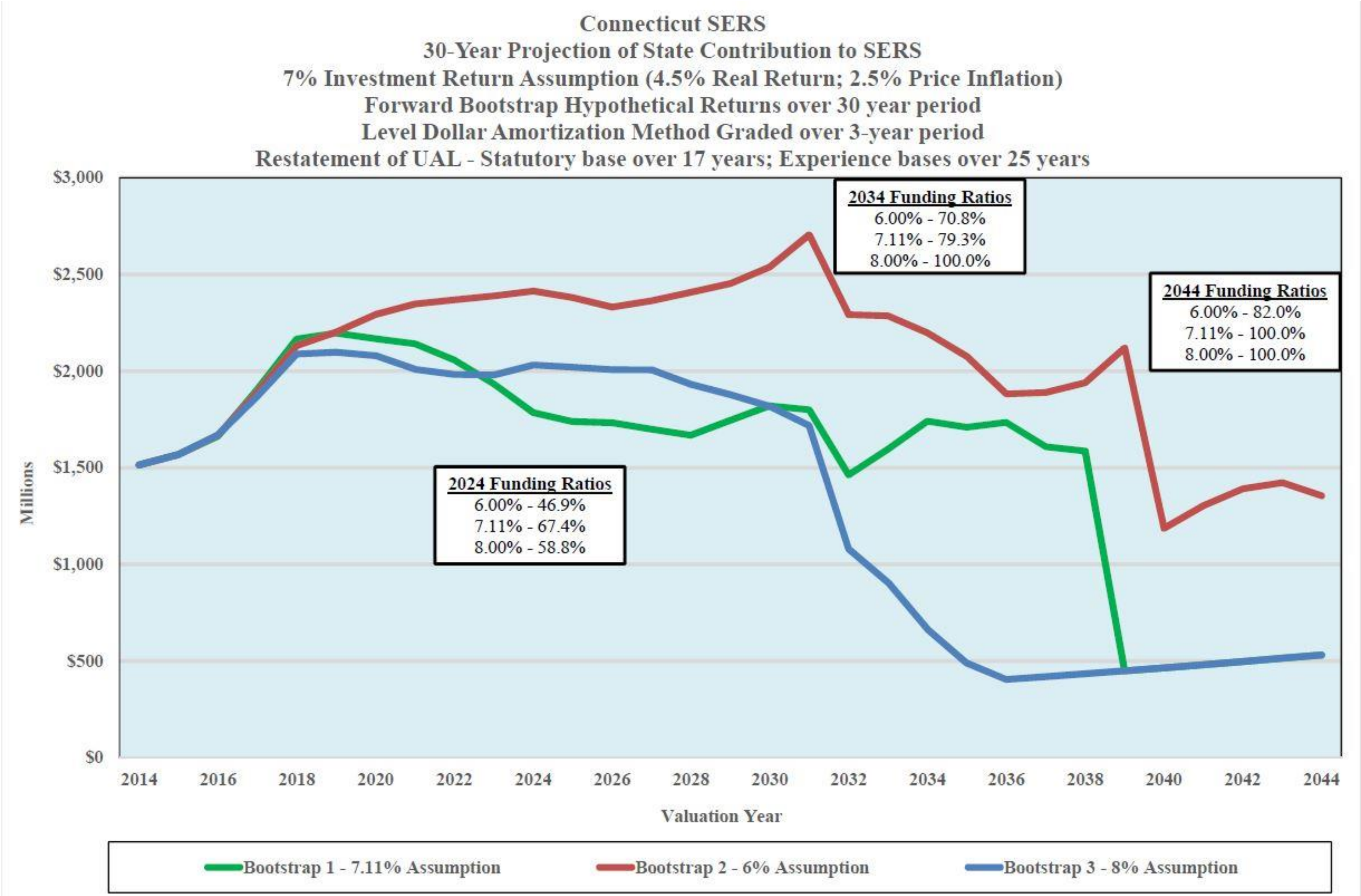
Benefits of Alternative Funding Policy

- 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

Sensitivity Analysis – Current Funding Policy



Sensitivity Analysis – Alternative Option



Primary Challenge to Reform

Ramping up payments in short-term

	Total State Contribution (in Thousands)		
Fiscal Year	Current ARC Schedule	Alternative Option	Difference
2018	1,652,306	1,637,449	-14,857
2019	1,712,681	1,841,893	129,212
2020	1,775,581	2,056,031	280,450
2021	1,856,053	2,085,431	229,378
2022	1,927,014	2,088,521	161,507
2023	2,009,159	2,090,296	81,137
2024	2,096,663	2,092,036	-4,627

Comparing Apples to Apples

	Total State Contribution (in Thousands)		
Fiscal Year	Current ARC Schedule - 7% Return	Alternative Option	Difference
2018	1,917,139	1,637,449	-279,690
2019	1,987,109	1,841,893	-145,216
2020	2,059,130	2,056,031	-3,099
2021	2,148,553	2,085,431	-63,122
2022	2,229,162	2,088,521	-140,641
2023	2,323,078	2,090,296	-232,782
2024	2,423,340	2,092,036	-331,304

Questions

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