How lottery fund and asset transfers could shore up Connecticut pensions

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Connecticut Treasurer Denise Nappier recommended using lottery revenues and transferring underused state assets into a trust to shore up the Teachers' Retirement Fund, the state's largest pension system.

Speaking before the Pension Sustainability Commission on Friday, Nappier said the lottery infusion and the asset transfer could pump $3 billion into a system that is only 57.7% funded.

Red-flag ratios

States with lowest pension funding levels

Source: Federal Reserve
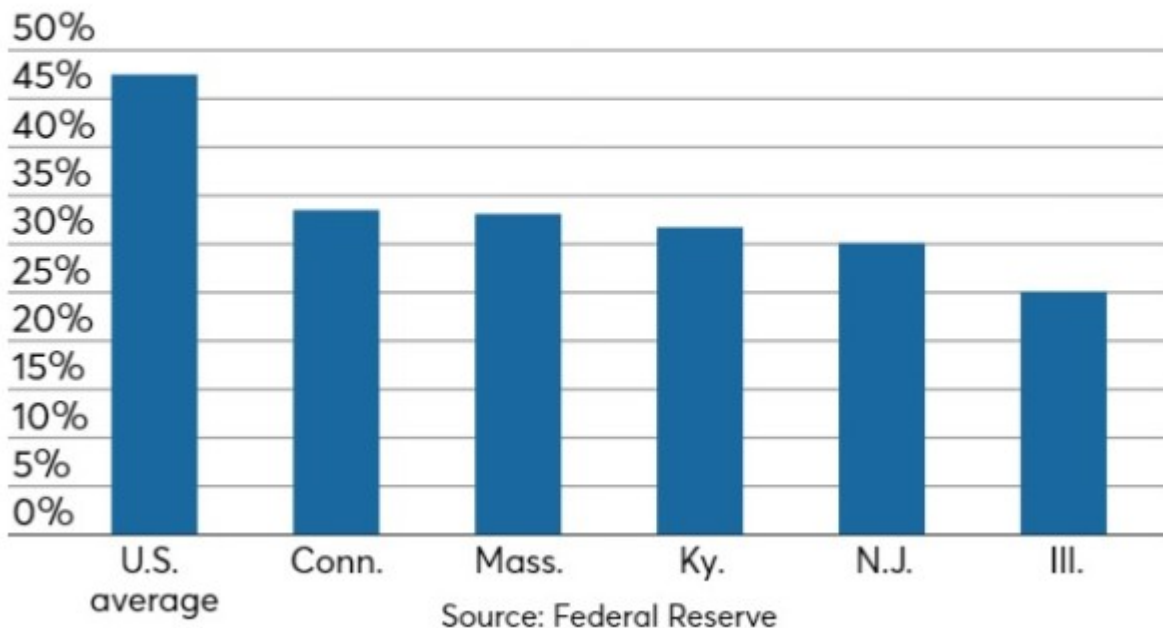
Nappier also called for lowering the fund's long-term investment return assumption to 7.5% from 8% and paying off pension bonds early in fiscal 2026 to remove covenant restrictions.

Following the payoff, said Nappier, the state could re-amortize the remaining unfunded liability and further reduce the investment return assumption to 7%, "consistent with capital market expectations."

Napier, who did not run for re-election and will leave the treasurer's office in January after five terms, said her proposal would generate net general fund savings of $440 million from fiscal 2020 through 2025.

Nationally, adjusted net pension liabilities have hit $1 trillion for U.S. states, according to Fitch Ratings.

"Many of the net pension liabilities that states have comprise pension obligations for non-state employees, usually local teachers, legally carried and directly funded by the state," said Douglas Offerman, a Fitch senior director.

Nearly all states with the highest pension burdens reflect this dynamic, according to Offerman.

The U.S. Federal Reserve lists Connecticut's funded ratio at 33.5%, the fifth-worst among the states, behind Illinois, New Jersey, Kentucky and Massachusetts.

Three factors, said Nappier, led to the deterioration of the Teachers' Retirement Fund: playing catch-up with funding of legacy costs incurred before 1979; consistent underpayment of actuarially required contributions; and unrealistic long-term assumptions.

"For too long, Connecticut's state government has regarded pension funding as tomorrow's problem," she said.

Fellow Democrat Shawn Wooden, a partner at law firm Day Pitney LLP and a former Hartford City Council president, will succeed Nappier as treasurer.

The TRF listed $18.1 billion in assets as of Sept. 30 and $31.1 billion of liabilities as of June 30, according to the latest valuation by Cavanaugh Macdonald that the Teachers' Retirement Board approved two weeks ago.

Nappier said her proposal would preserve Connecticut's bond ratings, mitigate a projected spike in payments and help maintain discipline essential to the sustainability of the TRF and Connecticut's fiscal health.

The state has an estimated $35 billion pension gap overall while its five largest cities — New Haven, Bridgeport, Hartford, Waterbury and Stamford — owe $2.1 billion. An April report by Pew Charitable Trusts listed Connecticut among five state retirement systems less than 50% funded.

The TRS and the State Employees' Retirement System are its two largest pension funds.

Connecticut last year received downgrades from all four bond rating agencies, which cited budget imbalance and high legacy costs.

Moody's Investors Service rates Connecticut's general obligation bonds A1, while S&P Global Ratings and Kroll Bond Rating Agency assign A and AA-minus ratings, respectively. Fitch Ratings rates them A-plus.

The pension funds, according to Nappier, could benefit from the creation of a legacy obligation trust through a value increase or dividend. She said a "prudent" transfer of state assets could occur within pension-fund governance parameters.

The trust, she said, would be a separate legal entity run by managers incentivized to maximize the value of assets previously underused. Pension funds would receive certificates of trust, or "marketable securities."

The state Treasury's general counsel, Catherine LaMarr, said the trust "has great merit" while calling for a structure necessary to preserve tax-exemption.

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