

1. Reform the Teachers Retirement System (TRS) to achieve the same budgetary stability as provided by the State Employee Retirement System.

In 2017, the State and the State Employee Bargaining Coalition (SEBAC) collectively bargained, and the legislature approved, a resolution to the unsustainable spikes in the State's required contribution to the state employee retirement system caused by the unfunded liabilities.

The 2017 agreement replaced the untenable increases in the State's annual required contributions (ARC) during the closed amortization period ending in 2032 with achievable and predictable annual contributions. And it requires the state to make the ARC payment in full every year. It achieved this by lengthening the payment plan for a portion of the unfunded liabilities from 15 years to 30, allowing the State to pay slightly more in the beginning but maintaining a level payment over the years, rather than facing a budget busting spike in 12-15 years. The negotiated agreement also adopted a more reasonable, lower assumed rate of return, reducing it from 8% to 6.9%. [This last change increased the projected nominal liability, but reduced the likelihood that the plan would in the future fall short of its projected return, requiring a drastic, unexpected spike in the ARC to cover the shortfall.]

The Teachers' Retirement System (TRS) should do the same. TRS still has a full funding date of 2032, an assumed rate of return of 8.5%, and an untenable spike of State contributions for past service liability that are locked in by bond covenants that run to 2032. Changing that system is extremely difficult, because of the terms of bond covenants agreed to when the state issued 2 billion dollars in pension obligation bonds in 2008. Nevertheless, essential revisions can and must be achieved. A strong statement by this Commission concerning the necessity of change would focus the state's attention on this matter.

A brief history of the unfunded liability in TRS

The Boston College Center on Retirement Research looked back at our two largest state-wide pension systems in its Report issued in 2015. TRS has been providing retirement benefits to its members since at least 1939. And, like SERS, for much of TRS' history, benefits were paid as they came due, directly from annual appropriations by the State. Retirement benefits earned by teachers prior to 1979 were completely unfunded by the State (although partially pre-funded through teachers' contributions). When the State first decided to pre-fund benefits in 1979, it was immediately presented with an unfunded liability for benefits earned by employees during the pay-go years. And, starting immediately thereafter, the state did not fully fund its' actuarially required contributions. The State's underpayment of the ARC began as soon as the State decided to pre-fund. At the outset, state law provided for a ramp-up schedule in the State's funding

requirement. In 1979, the state was only required to pay 35 percent of the ARC. This percentage was scheduled to gradually increase each year until 1993, when the State would be required to pay the full ARC. But, even after 1993, the state did not make its full required contributions.

The unfunded liability that is owed to TRS cannot be extinguished even if the current defined benefit plan were to be changed to a defined contribution plan, with both the state and the individual teacher contributing to the plan. INDEED, the unfunded liability that is owed to TRS cannot be extinguished even if every single active teacher in the State went to a completely self-funded IRA. The focus on cutting benefits, removing retirement benefits from collective bargaining, and/or changing to a defined contribution plan is completely unrelated to how the State addresses its overhanging unfunded liability. The generosity of benefits and collective bargaining are neither the cause of the growth in the State's unfunded liability nor a solution to it.

As reported in the Boston College, Center on Retirement Research study, there are three factors behind the current unfunded liability of TRS: 1) legacy costs due to benefits promised before TRS was pre-funded, 2) a history of inadequate contributions once the State decided to pre-fund, and 3) poor investment experience relative to expectations since the turn of the century. Since 1983, the UAAL has grown by \$10.5 billion – from an initial value of \$2.5 billion to a value in 2017 of \$13 billion. The two largest contributors to the growth in the UAAL have been inadequate contributions and lower than expected investment returns. The Pension Obligation Bond (POB) issued by the State in 2008 lowered the UAAL by \$2 billion, but simultaneously increased the State's overall indebtedness by \$2 billion. The bond covenant achieves what collective bargaining achieved in SERS by binding the State to making its full ARC payment each year but, unfortunately also locked in the unreasonable assumed rate of return to 8.5% and required the UAAL be paid in full by 2032.

Like SERS, the main driver of contributions to TRS is the unfunded liability, not the level of benefits or the cost of current benefit accruals. The total normal cost as a percent-of-payroll (employee contributions plus employer normal cost) permits a clear comparison among plans. The cost of benefits provided to members of TRS actually falls below that of teachers' plans nationally, and the State's normal cost (3.7% of payroll) is half of the national average (7.4%). Teachers in Connecticut already contribute 6% of their pay to TRS, more than the national average of 5.6%.

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Proposed Solution

The laws and bond covenants currently governing the TRS are irresponsible and undisciplined. Simply put, to do nothing to change those unbearable restrictions on prudent pension management will be destructive to our State's fiscal health, budget stability, and economic growth. We must bring the stakeholders together to create a means to establish a more predictable and manageable payment schedule moving forward.

It is understood that any reform must necessarily extend amortization for a portion of the unfunded liabilities from the current 14 years to something closer to 30 years in order to avoid the extreme spikes in state contributions presently facing us. It also must adopt a more conservative and realistic assumption about the rates of return the pension fund investments will achieve in the financial markets each year. At the same time, the state's obligation to pay both the normal cost and the cost of amortizing past service liability must not be diminished.