PRELIMINARY FISCAL NOTE
SR 7/HR 8

Appropriations Committee Meeting

January 24, 2017

OFFICE OF FISCAL ANALYSIS
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SR 7and HR 8 - Resolutions Proposing Approval of an Agreement between the State of Connecticut and the State Employees Bargaining Agent Coalition (SEBAC).

The provisions of the agreement lower the projected actuarial determined employer contribution (ADEC) by $220 million in FY 18 (and estimated $154 million in General Fund and $18 million in Transportation Fund) and $120 million in FY 19 (an estimated $84 million in General Fund and $10 million in Transportation Fund), while increasing the unfunded actuarial accrued liability by $6.77 billion (a 45% increase). As summarized in **Table 1.1**, if the provisions of the agreement are not implemented the FY 18 ADEC will be $1.87 billion (compared to $1.65 billion) and $1.94 billion in FY 19 (compared to $1.82 billion). Further discussion about the impact to the UAAL and the ADEC from the agreement is provided in the following pages.

Table 1.1 ADEC Under Current Schedule Compared to ADEC Under Agreement
($ billions – All Funds)

	ADEC - Current Schedule	ADEC - Under Agreement	Difference
FY 18	1.87	1.65	(0.22)
FY 19	1.94	1.82	(0.12)

Total General Fund and Special Transportation Fund estimated costs associated with the agreement are $1.30 billion in FY 18 and $1.43 billion in FY 19, which reflect approximately 79% of the ADEC of $1.65 billion and $1.82 billion respectively for the State Employees' Retirement System (SERS). A summary of the specific provisions of the agreement is provided at the conclusion of this document.

Impact to the Actuarial Determined Employer Contribution (ADEC)

Table 1.2 on the following page provides a breakout of the impact on the FY 18 and FY 19 ADEC from provisions contained in the agreement and those factors which are not contained in the agreement.

I. FY 18 ADEC

The provisions of the agreement partially offset the $300 million increase between the FY 17 ADEC and the FY 18 ADEC by $220 million; therefore resulting in an increase of $80 million between FY 17 and FY 18.

Provisions of the agreement, including decreasing the discount rate to 6.9% and changing amortization methods to entry age normal increase the ADEC by $220 million ($190 million and $30 million respectively). At the same time, changing the amortization period (e.g. splitting the UAAL into pre-1984 and post-1984, extending the UAAL for the post-1984 portion, and implementing a 25 year layer amortization methodology) reduce the ADEC by $440 million.

Non-agreement demographic changes and actual plan experience account for a $300 million increase between the FY 17 and FY 18 ADEC.

II. FY 19 ADEC

The increase between the FY 18 and FY 19 ADEC is $170 million with the agreement. The change to a level dollar amortization methodology contained in the agreement is being phased in over five years and accounts for $100 million of the increase between the FY 18 and the FY 19. FY 19 is the first year the change is reflected.

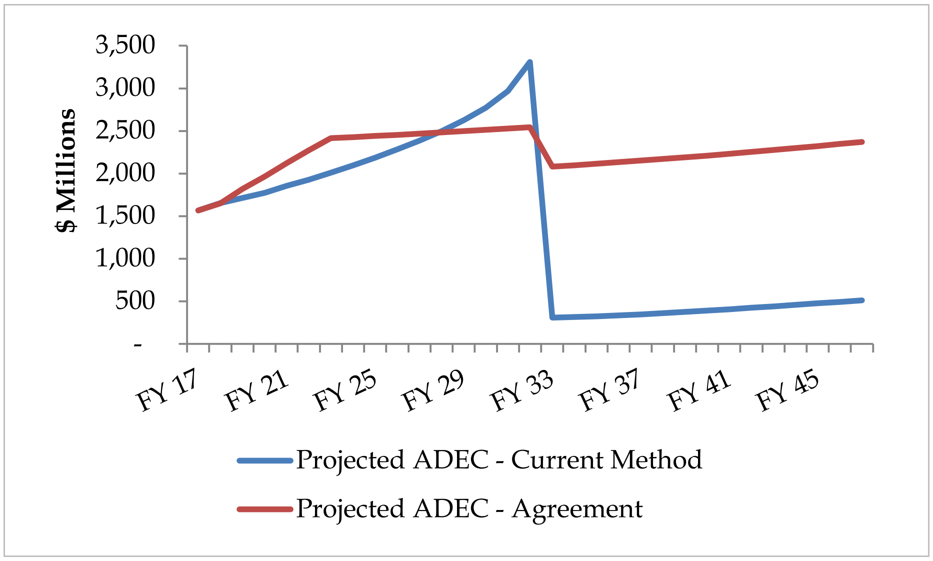
Non-agreement demographic changes and expected plan experience account for a $70 million increase between the FY 18 and FY 19 ADEC.

Table 1.2 Impact of the Agreement on the SERS Actuarial Determined Employer Contribution for FY 18 and FY 19

	Actuarial Determined Employer Contribution (ADEC) ($ in billions - All Funds)
FY 17 ADEC (6/30/14 Valuation)	**1.57**
Provisions of Agreement Impacting the FY 18 ADEC	
Change to Entry Age Normal	0.03
Change in Amortization Period	(0.44)
Change in Economic Assumptions (6.9% Discount Rate)	0.19
Total Agreement Changes	**(0.22)**
Non- Agreement Changes Impacting the FY 18 ADEC	
Actual Experience of the Plan	0.15
Demographic Assumption Changes	0.15
Total Non-Agreement Changes	**0.30**
FY 18 ADEC (6/30/16 Valuation)	**1.65**
Provisions of Agreement Impacting the FY 19 ADEC	
Phase in Level Dollar Amortization Methodology	0.10
Total Agreement Changes	**0.10**
Non- Agreement Changes Impacting the FY 19 ADEC	
Expected Experience of the Plan	0.07
Total Non-Agreement Changes	**0.07**
FY 19 ADEC (6/30/16 Valuation)	**1.82**

Figure 1.1 reflects the projected ADEC if the agreement is not implemented for the period FY 17 to FY 47 and the impact to the projected ADEC if the agreement is implemented.[1]

Figure 1.1 Projected ADEC



Impact to the Unfunded Actuarial Accrued Liability (UAAL)

Provisions of the agreement account for $4.57 billion (or 68%) of the total $6.77 billion increase in the SERS UAAL. Specifically, decreasing the discount rate from 8% to 6.9% makes up approximately 55% (or $3.70 billion) of the increase in the UAAL. Secondly, changing the amortization method from projected unit credit to entry age normal accounts for 13% (or $870 million) of the increase in the UAAL.

Non-agreement related changes, including demographic changes[2] and actual plan experience, account for $2.20 billion (or 32%) of the increase in the UAAL.

Table 1.3 on the following page provides a breakout of the impact on the UAAL from provisions contained in the agreement and those factors which are not contained in the agreement but have resulted in an increased in the UAAL since the June 30, 2014 valuation.

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[1]The current method is based on the June 30, 2014 SERS valuation and therefore does not reflect the potential impact of actual plan experience for the period between the 2014 and 2016 valuation and does not reflect the impact of demographic changes reflected in the 2016 valuation.
[2]Demographic changes were adopted by the Retirement Commission based on the SERS Experience Study for the four year period ending June 30, 2015 and are not included as provisions of the agreement.

Table 1.3 Impact of Agreement and Non-Agreement Provisions on the SERS UAAL

	Unfunded Actuarial Accrued Liability ($ in billions)
2014 Valuation	**14.92**
Provisions of Agreement	
Change to Entry Age Normal	0.87
Change in Amortization Period	0
Change in Economic Assumptions (6.9% Discount Rate)	3.70
Total Agreement Changes	**4.57**
Non-Agreement Changes	
Actual Experience of the Plan Between 2014 and 2016	0.85
Demographic Assumption Changes	1.35
Total Non-Agreement Changes	**2.20**
2016 Valuation	**21.69**
Total Change from 2014	**6.77**

Supplemental Summary Information:

Table 1.4 below provides a comparison of the June 30, 2014 and the June 30, 2016 valuation. The June 30, 2016 valuation incorporates the provisions of this agreement.

Table 1.4 Comparison of June 30, 2014 and June 30, 2016 SERS Actuarial Valuation

	June 30, 2014	June 30, 2016	% Change	Amount Change
Accrued Liability	25,505,636,777	33,616,716,085	31.80%	8,111,079,308
Actuarial Value of Assets	10,584,795,257	11,922,965,860	12.64%	1,338,170,603
Unfunded Liability	14,920,841,520	21,693,750,225	45.39%	6,772,908,705
Funded Ratio	41.50%	35.50%	-14.46%	-
Actuarial Determined Employer Contribution (ADEC)				
Normal Cost	278,812,817	365,570,268	31.12%	86,757,451
Accrued Liability	1,235,654,507	1,282,836,995	3.82%	47,182,488
Total ADEC[1]	1,514,467,324	1,648,407,263	8.84%	133,939,939
Active Members	49,976	50,019	0.09%	43
Retired Members	45,803	48,191	5.21%	2,388
Years Left in Amortization Period[2]	17	25.1	-	-

[1]ADEC for the first year of the valuation (FY 16 and FY 18, respectively).
[2]For June 30, 2016 this reflects the average amortization period remaining.

Agreement Provisions:

The agreement contains the following provisions:

1. Unfunded liability will be computed using entry age normal (EAN). Currently, SERS uses projected unit credit (PUC). In general,
    a. EAN creates level contributions throughout an employee's career; and
    b. PUC attempts to fund benefits as they accrue, creating lower costs at the beginning of an employee's career and increasing contributions as the employee nears retirement and presumably salary increases.
2. Pension funding method will be level dollar (LD). This method will be phased in over five years. Currently, SERS uses level percentage of payroll (LPP). In general,
    a. LD requires equal dollar amounts to be paid over a given number of years (the amortization period/payoff term); and
    b. LPP calculates amortization payments as a constant percentage of projected payroll over a given number of years (the amortization period/payoff term).
3. Unfunded accrued liability (UAL) as of 1984 will be paid off by the end of the current amortization period in 2032.
    a. The UAL as of 1984 is approximately $4.3 billion; and
    b. The total SERS UAL is $14.9 billion as of 6/30/14.
4. The balance of the UAL, approximately $10.6 billion, will be paid off in 2047.
    a. An additional 15 years is being added to the current amortization period for the portion of the UAL attributed to the period after 1984.
5. Actuarial gains and losses will be amortized using a 25 year layered amortization approach.
6. Recommend the Retirement Commission adopt an investment rate of return assumption of 6.9%.
    a. The Retirement Commission voted to adopt 6.9% at the commission meeting on 12/15/16.
    b. The SERS investment rate of return was previously 8%.