I. Introduction – Treasurer Denise L. Nappier

Over the course of the past month, there have been intense and sobering discussions of the state of our fiscal affairs. Persistent near-term budget deficits and structural weaknesses in our revenue streams, coupled with the realities of ever-mounting long-term liabilities, have underscored the necessity of a pragmatic, multi-faceted solution that balances a great many compelling interests.

Which is why I commend Governor Malloy for focusing our collective attention on the challenges of balancing short-term needs against the imperative of addressing our long-term liabilities.

Statement of Pension Funding Problem

What brings the issue of the state's financing of unfunded liabilities to the forefront today is a recent study conducted by the Center for Retirement Research at Boston College and commissioned by the Governor's administration which projects, among other things, a balloon payment of $13 billion dollars ($6.7 billion for SERS and $6.2 billion for TRS), based on the current policy of reaching fully funded status by 2032 for both SERS and TRS. With all due respect to the Center, this is a projection based more on conjecture and/or a flawed calculation than an explicit long-term actuarial return assumption (or discount rate). But more on that later on in this presentation.

According to the study, the funded status of SERS and TRS of 42% and 59%, respectively, declined over the past decade by approximately 20 percent. And, as I've often stated during this period of time, the pension system's liabilities have more often than not grown at a faster pace than assets. Equally troubling is that the bulk of the state's annual contribution has represented payments to amortize the unfunded past service liability. For example, in 2014, the state contributed $2.2B, of which $1.8B represented payment against the unfunded liability for both SERS and TRS, all of which was disbursed to meet pension benefits. Plus an additional $670 million was swept from the pension fund in 2014 to fully meet pension benefit payroll.

The Governor's Proposal

With respect to the proposal offered by the Governor weeks ago, there are many points on which we agree:

- Lowering the investment return assumption to conform more realistically to our expectations for how capital markets will perform going forward;
- Changing the method for funding the State's contribution to SERS from level percent of payroll to level dollar, which will stop the back-loading of payments;
- Converting to a rolling amortization period for SERS at a point where the funded status of the Funds is stronger; and
- Avoiding gimmicks such as retirement incentive programs.

We also agree that there are many more questions to answer and hurdles to overcome.

What has given me pause, however, is the proposal that we split off the unfunded accrued actuarial liabilities and create a "pay-as-you-go" system for Tier I retirees. It is a material departure from the hard-fought disciplined funding approach to the State's pension liabilities – now solidified in contract for the State Employees' Retirement Fund ("SERF") and by a covenant for the Teachers' Retirement Fund ("TRF"). Connecticut didn't earn the dubious distinction of having some of the nation's worst funded ratios overnight – that was the result of many factors, including the shorting of contributions into the pension funds, year after year.

In my opinion, the merits of an unqualified pay-as-you-go option for the unfunded past service liabilities (primarily representing retired members hired before 1984 for SERF and before 1979 for TERF) would be more prone to near certain challenges regarding the state's creditworthiness -- that it represents another credit weakness. It also raises many serious legal and implementation questions. Based on the information available, I therefore believe we should not be so quick to partially abandon an actuarially funded system without giving further consideration to how the current system might be better funded in a manner that is sustainable until the unfunded past service liability is extinguished actuarially.

However, if a pay-as-you- go approach is pursued, then there must be an ironclad commitment to funding the benefits.

As principal fiduciary of the assets of the pension funds and steward of the investment program designed to help the State honor its commitments to retirees, I am concerned about the potential consequences of Governor Malloy's proposal for the investment program. I am also keenly aware of the obligations owed to

Connecticut's taxpayers, and the growing general fund impact of the current pace of annual pension payments.

However the ultimate solution is structured, it is imperative that certain fundamental principles be maintained in any alternative to the current funding method:

- Maintain a disciplined approach to funding the State's long-term obligations.
- Protect the State's creditworthiness depends on abiding by this discipline.
- Ensure the overall soundness and integrity of the SERF and TRF.
- The State's commitment to its retired employees is inviolate.
- Minimize the burden on taxpayers and future generations.
- Preserve and enhance long-term investment performance.
- Base future assumptions of investment returns on capital market outlook and related asset allocation policy as determined by the investment arm of the state's retirement system.

With that said, my staff, our consultants and I have evaluated the Governor's proposal for both the State Employees' Retirement System and the Teachers' Retirement System, and we will present our preliminary observations and analysis today. So, without further ado, I will turn this portion of the presentation over to Treasury staff.