The Office Of State Treasurer
Denise L. Nappier
News

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## STATE TREASURER NAPPIER PRESENTS PRELIMINARY ANALYSIS OF GOVERNOR'S PENSION FUNDING PROPOSALS
### *CALLS FOR IRON-CLAD GUARANTEE OF STATE'S PAYMENTS TO RETIREES*

HARTFORD, CT – State Treasurer Denise L. Nappier this week released the preliminary results of an analysis of Governor Dannel Malloy's proposals for funding the State's largest pension plans, and offered recommendations that would maintain the integrity of the actuarially designed plans.

At a Wednesday meeting of the State's independent Investment Advisory Council ("IAC"), she supported reforms that would:

- Phase-in a reduction of the investment return assumption, from 8 percent to 7 percent, in order to conform more realistically to expectations for how capital markets will perform going forward. This transition approach will ease budgetary pressure, given that the State's annual pension contributions will grow when the return assumption is lowered, and have the added benefit of being a "credit positive" according to Moody's Investors Service.[1]

- Change the method for calculating the State's contributions to the State Employees' Retirement Fund ("SERF"), from level percent of payroll to level dollar. This will improve the funded status more quickly by employing a more aggressive plan for paying down the unfunded pension liability.

- Convert to a rolling amortization period when the funded status of SERF reaches an adequate level at 75 percent. This would delay full funding, but place less pressure on financing the unfunded liabilities by smoothing annual pension contributions and avoiding a balloon payment when compared to the current closed 2032 amortization schedule.

- Avoid gimmicks such as retirement incentive programs.

Treasurer Nappier reiterated her concern over the proposal to create a pay-as-you-go plan for Tier 1 retirees, separate and apart from a fund for remaining active employees. She stated that such a move "is a material departure from the hard-fought disciplined funding approach to the State's pension liabilities" and "raises many serious legal and implementation questions. If this is an option that is ratified by the Governor and General Assembly, then there must be an iron-clad commitment to paying the monthly

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[1] *See Connecticut Lowers Assumed Investment Return Rate for Teachers Pensions, a Credit Positive* dated November 16, 2015.

benefit payroll as well as the annual required contribution for the remaining actuarial plan for active employees."

During the presentation, Nappier's staff questioned a key aspect of a study conducted by Boston College's Center for Retirement Research, which formed the basis for Governor Malloy's proposal. Chief Investment Officer Deborah Spalding pointed out that the Center projected the growth in the State's contributions to SERF under current law, and that it used different rates for valuing the assets and liabilities of the plan. "By assuming that the liabilities will grow by 8% over the next 17 years, while the assets will grow at just 5.5%, the Center created the appearance of a potential balloon payment of $6.6 billion for SERF in 2032. Had the same rate been applied to both assets and liabilities, the spike could be cut by $3 billion," Spalding said.

Treasurer Nappier made clear that whatever investment return assumption is used, there is "no investment strategy that would, in and of itself, allow us to earn our way out from under these unfunded liabilities The State needs to pay off the unfunded liabilities one way or another."

Concerning the Teachers Retirement Fund ("TRF"), Treasurer Nappier said she concurs with the advice of the Treasury's bond counsel that it is unlikely that changes can be made to either the method of calculating the State's contribution (funding method) or amortization period for funding the plan – currently expected to be fully-funded in 2032. Either change, in counsel's view, would likely violate a covenant adopted in conjunction with the issuance of pension obligation bonds in 2008. Nappier left open two possibilities: (1) adjusting the State's contribution into the plan once the funding of the TRF hits 75 percent – in compliance with the bond covenant -- which is expected in 2028; and (2) considering the smoothing of actuarial losses over a longer horizon than the current four years.

Treasurer Nappier emphasized that however the State addresses these challenges, certain principles were sacrosanct: the State must "maintain a disciplined approach to funding the State's long-term obligations, protect the State's creditworthiness by adhering to this discipline, minimize the burden on taxpayers and future generations, and preserve and enhance long-term investment performance."

"We are mindful of the State's history of underfunding its pension systems and we don't want to be doomed to repeat it," she told the IAC.

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