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Contact: Tara Downes
860-702-3308
Tara.Downes@ct.gov

COMPTROLLER LEMBO RELEASES DETAILED PENSION FUNDING ANALYSIS WITH EVIDENCE-BASED REFORM RECOMMENDATION

PLAN WOULD SAVE $1 BILLION OVER CURRENT METHODOLOGY

Comptroller Kevin Lembo, after working closely with pension experts and actuaries to investigate pension reform solutions, has released a detailed analysis of state pension funding options and offers an evidence-based recommendation using actuarial best practices that would save the state $1 billion over the current funding methodology.

"Pension reform – like any important public policy challenge – demands that we build a solution on data, research and actuarial best practices," Lembo said.

In a letter and report to Gov. Dannel P. Malloy and the State Employees Bargaining Agent Coalition (SEBAC), Lembo said all can agree that there is a growing consensus on the desired goals of any pension reform solution for the State Employees' Retirement System (SERS), including:

- Ensuring adequate payments to meet our obligations
- Preserving and strengthening the state's bond rating
- Enhancing cost stability and predictability
- Maximizing investment returns to offset future General Fund obligations

"Cost stability and predictability, in particular, must be the focus of any conversation about Connecticut's budget, tax policy and – in this case – pension funding," Lembo said. "As I emphasized in advocating the Budget Reserve Fund reform that was adopted last year, we must tame volatility and introduce much-needed predictability."

Lembo's detailed report on his findings features three pension funding scenarios – as well as a "baseline" scenario that allows policymakers to compare the state's current funding policy to possible solutions.

All of the concepts that Lembo analyzed retain all retirees (all tiers) in the existing State Employees' Retirement Fund with benefits prefunded through employer and employee contributions. All concepts also utilize closed amortization periods – setting a finite date by which the state's unfunded pension liabilities will be paid off. And finally, all of the scenarios lower the pension fund's assumed rate of return from 8 percent to 7 percent, as recommended by state Treasurer Denise Nappier.

Lembo said that one of these concepts – Scenario 3 (the third and final concept presented) – stands out above the others.

"This concept – which I strongly recommend – would not only establish cost stability and predictability, but it would save the state approximately $1 billion in long-term pension costs when compared to the current funding methodology," Lembo said.

This recommended concept would do the following:

- Lower the assumed rate of return from 8 percent to 7 percent.
- Change amortization method to level dollar (akin to a fixed-rate mortgage with equal payments throughout the term).
- Split the state's unfunded liability into two categories – one category (referred to as "statutory base") refers to the actuarial liability accumulated before and up to Dec. 31, 1983 and another category (referred to as "experience base") for actuarial experience from 1984 to present. The statutory base liability would remain on the current 16-year amortization period, while the experience base liability would be amortized over 25 years.

Adopting these changes would deliver the following results:

- Saves the state more than $1 billion in real dollars over the course of the amortization period.
- Total costs reduced over all other pension funding scenarios, including the current funding methodology, adjusting for inflation.
- Establish a predictable and stable flat payment schedule.
- Higher projected funding ratios.

- Requires larger ARC (Annual Required Contribution) payments in near term in order to reduce cost burden significantly in future years.

"This proposal provides certainty and stability, improves the SERS funding ratio, helps guard against future budgetary challenges, protects the state's bond rating and maximizes investment earnings," Lembo said.

In addition to the recommended pension funding reform, Lembo also proposed that the state commit to regular independent comprehensive audits of the plans' actuarial valuations to determine the reasonableness of the actuarial methods and assumptions being used.

"Such regular audits will help right the ship should the state begin to veer off course again," Lembo said. "As I have said before, I am grateful that the Governor has raised the important issue of fixing the state's broken pension funding system. I am also thankful for Treasurer Denise Nappier's constructive and experienced input in the early days of this discussion. I look forward to working with all parties to reach a collaborative, data-based solution to the state's pension funding crisis."

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