GOVERNOR LAMONT'S PROPOSED CHANGES TO CONNECTICUT'S TEACHERS' RETIREMENT SYSTEM (TRS)

April 25, 2019

Governor Ned Lamont's proposed biennial state budget for fiscal years 2020 and 2021 contains several changes to the Connecticut Teachers' Retirement System (TRS).[1] Connecticut's Teachers' Retirement System (TRS) is a defined benefit plan that disburses a fixed pension benefit to participating teachers upon retirement.[2,3] Connecticut's TRS has been in operation since 1939 and is currently funded by the State of Connecticut and contributions from teachers.[4] However, the TRS has accumulated more than $13.1 billion in unfunded liabilities and has one of the lowest funded ratios (57.7 percent) in the United States among similar plans.[5]

The primary reasons for the poor health of the TRS include: the State of Connecticut making no contributions to the fund prior to 1979, the multitude of years since 1979 in which the State failed to make its full annually required contribution (ARC), and the investments made by the fund failing to meet their assumed rate of return in recent years.[6] Additionally, the TRS is constrained by a bond covenant for $2.27 billion in pension obligation bonds sold by the State of Connecticut in 2008.[7] The bond covenant stipulates the State of Connecticut must make its full ARC, and the Connecticut General Assembly cannot change the ARC amount until the bonds reach maturity in 2032.[8] There are two exceptions to these restrictions: 1) if an "adequate provision" is made by law for the protection of the bond holders, or 2) the governor declares a state of emergency, at least three-fifths of Connecticut's House of Representatives and State Senate vote to diminish the State's ARC during the biennium for which the emergency exists, and the funded ratio for TRS is at least equal to the funded ratio immediately after the sale of the pension obligation bonds in accordance with the actuarial method used at the time.[9]

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[1] S.B. 873: An Act Stabilizing the Teachers' Retirement Fund. Gen. Assembly. (Ct. 2019). https://www.cga.ct.gov/2019/TOB/s/pdf/2019SB-00873-R00-SB.PDF.
[2] For a more in-depth discussion of the TRS, please see:
Connecticut School Finance Project. (2018). *Connecticut's Teachers' Retirement System (TRS)*. New Haven, CT: Author. Retrieved from http://ctstatefinance.org/assets/uploads/files/CT-Teachers-Retirement-System.pdf.
[3] Campbell, J., Gellman, C., & Moran, J. (2010). *State Employees and Teachers' Retirement Systems* (2010-R-0268). Hartford, CT: Connecticut General Assembly, Office of Legislative Research. Retrieved from https://www.cga.ct.gov/2010/rpt/2010-R-0268.htm.
[4] H.B. 7150: An Act Implementing the Governor's Budget Recommendations Concerning Education. Gen. Assembly. (Ct. 2019). https://www.cga.ct.gov/2019/TOB/h/pdf/2019HB-07150-R00-HB.PDF.
[5] Garrett, J.J., & Mobley, B.D. (2018). *Connecticut State Teachers' Retirement System Actuarial Valuation as of June 30, 2018*. Kennesaw, GA: Cavanaugh Macdonald Consulting, LLC. Retrieved from https://www.ct.gov/trb/lib/trb/forms/statisticsresearch/SR_ACTVAL18.pdf.
[6] Ibid.
[7] Nappier, D.L. (2008). *Annual Report of the Treasurer for the fiscal year ended June 30, 2008*. Hartford, CT: State of Connecticut, Office of the State Treasurer. Retrieved from http://www.ott.ct.gov/PDFs/Annual2008.pdf.
[8] Day Pitney LLP. (2016). *Letter to Connecticut State Treasurer Denise L. Nappier RE: Bond Covenant for Pension Obligation Bonds*. Hartford, CT: Author. Retrieved from http://ctstatefinance.org/assets/uploads/files/Day-Pitney-Opinion-on-Teacher-POBs.pdf
[9] Ibid.

The purpose of this document is to detail Governor Lamont's proposed changes to the TRS and to analyze the projected impact of these changes on the system and the State of Connecticut.

Governor's Proposed Changes

1. **Reamortize the current Unfunded Actuarial Accrued Liability (UAAL)[10]**
   The governor's proposal would amortize the UAAL over a 30-year period, switching the amortization method from a level percent of payroll amortization to level dollar amortization (phased-in over five years), and amortize future gains and losses over closed 25-year periods.[11] A level percent of payroll amortization can lead to balloon payments toward the end of the amortization period, while a level dollar amortization requires equal dollar payments over the period, which is projected to eliminate the possibility of balloon payments.[12] In addition, amortizing future gains and losses in this proposed manner is projected to smooth the impact of these fluctuations on the pension fund.

2. **Create a Teachers' Retirement Fund Bonds Special Capital Reserve Fund backed by a General Fund surplus and lottery receipts[13]**
   This proposed fund is designed as a "backstop" to the TRS in recognition of the "adequate provision" language established in the covenants of the pension obligation bonds issued in 2008.[14] Initial funding (approximately $381 million) would be provided from the FY 2019 General Fund surplus.[15] The fund is proposed to hold the "minimum capital reserve," that is, the maximum amount of principal and interest due on the pension obligation bonds in a given year, and receipts from the Connecticut Lottery Corporation are proposed to be directed into this fund if the balance of the fund falls below said "minimum capital reserve."[16]

3. **Reduce the TRS' assumed rate of return from 8 percent to 6.9 percent, in line with the State Employees Retirement System (SERS)[17]**
   Assumed rates of return impact the amount the State must contribute to the pension system each year, also known as the Actuarially Determined Employer Contribution (ADEC). If pension investments do not meet return assumptions, the system will require additional funding to make up for such a deficit. A lower assumed rate of return will require the State to contribute more each year because funds are expected to earn less investment income, but reduce the likelihood of requiring additional contributions in the future due to investment returns falling below the assumed rate.

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[10] S.B. 873: An Act Stabilizing the Teachers' Retirement Fund. Gen. Assembly. (Ct. 2019). https://www.cga.ct.gov/2019/TOB/s/pdf/2019SB-00873-R00-SB.PDF.
[11] Ibid.
[12] Minnesota State Legislature, Legislative Commission on Pensions and Retirement. (2011). *Background Information on the Amortization of Defined Benefit Retirement Plan Unfunded Actuarial Accrued Liabilities*. St. Paul, MN: Author. Retrieved from https://www.commissions.leg.state.mn.us/lcpr/documents/backgrounddocs/amortization_of_uaal.pdf.
[13] S.B. 873: An Act Stabilizing the Teachers' Retirement Fund. Gen. Assembly. (Ct. 2019). https://www.cga.ct.gov/2019/TOB/s/pdf/2019SB-00873-R00-SB.PDF.
[14] Ibid.
[15] Ibid.
[16] Ibid.
[17] Ibid.

4. **Limit credited interest on mandatory contributions to 4 percent annually[18]**
The Teachers' Retirement Board (TRB), which administers the TRS, adopted a six percent credited interest rate on member contributions to the Regular and Supplemental Accounts on June 30, 2018, as was its responsibility under current state statute.[19,20] The rate is applied to mandatory member contributions on a yearly basis, and the interest calculated is credited to members who withdraw their contributions from the fund. The governor's proposal seeks to limit the credited interest rate chosen by the TRB to no more than four percent in statute, which would decrease the amount of interest paid on member accounts and require less state resources.[21] For example, if a member contributed $1,000 to the fund in one year and sought to withdraw it from the fund, the State would credit four percent interest on that contribution ($40) rather than six percent ($60).

5. **Increase "Form N" member contribution account to 50 percent of benefit[22]**
Currently, if 25 percent of the aggregate benefit paid to a retiree prior to their death was less than the retiree's aggregated contributions, the retiree's beneficiary would be paid the difference between such aggregated benefits paid and member contributions.[23] The governor's proposal would increase the percentage to 50 percent of the aggregate benefit when computing the proposed lump sum payment.[24] This would reduce the expenditure required for this purpose by the State. For example, if a member contributed $100,000 to the fund, and received an aggregate benefit of $50,000, under the previous statute, this member's beneficiary would be eligible for a lump sum of the difference between 25 percent of benefits and contributions ($100,000 – $50,000 * .25 = $87,500 plus credited interest). Under the governor's proposal, this member would be eligible for a smaller lump sum payment ($100,000 – $50,000 * .50 = $75,000 plus credited interest).

6. **Alter the mechanism for reamortizing the unfunded liability of potential benefit increases[25]**
Currently, any "liberalization" of benefits cannot take place unless the General Assembly receives an analysis of the unfunded liability created by such change, and the liability must be amortized using the current amortization method.[26] This proposal changes the method for amortizing potential liabilities to the level dollar method described earlier, and changes the amortization period from 30 years to a time period "consistent with actuarial recommendations approved by the Retirement Board."[27]

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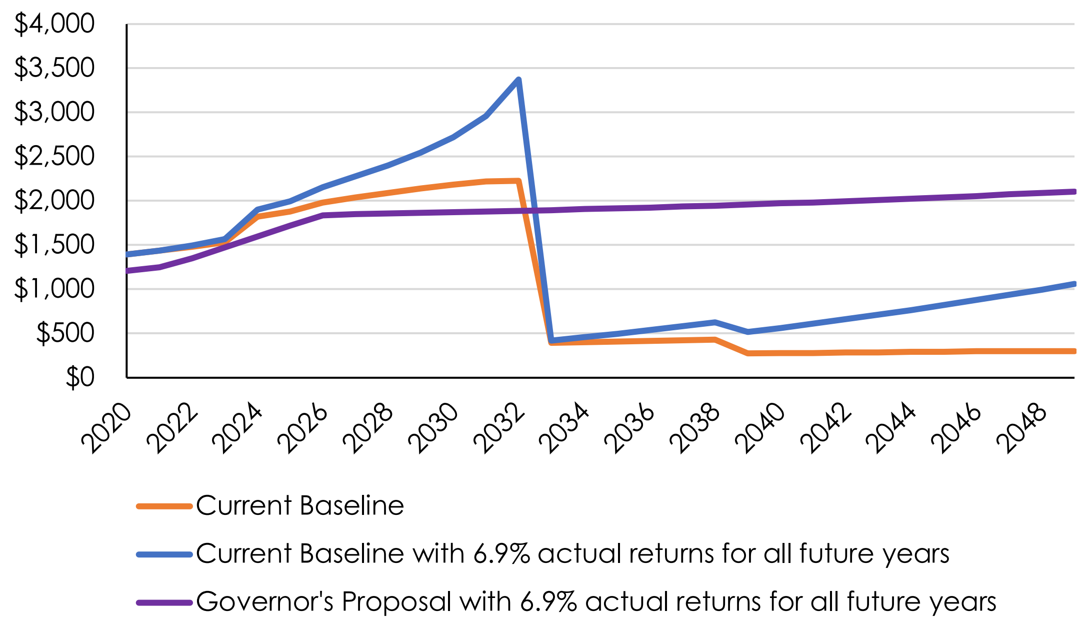
[18] Ibid.
[19] Connecticut Teachers' Retirement Board. (2018). *Credited Interest Rate and Investment Rate of Return Since 1963*. Hartford, CT: Author. Retrieved from https://www.ct.gov/trb/lib/trb/formsandpubs/intrates.pdf.
[20] Conn. Gen. Statutes ch. 167, § 10-183b(8).
[21] S.B. 873: An Act Stabilizing the Teachers' Retirement Fund. Gen. Assembly. (Ct. 2019). https://www.cga.ct.gov/2019/TOB/s/pdf/2019SB-00873-R00-SB.PDF.
[22] S.B. 872: An Act Implementing the Governor's Budget Recommendations for General Government. Gen. Assembly. (Ct. 2019). https://www.cga.ct.gov/2019/TOB/s/pdf/2019SB-00872-R00-SB.PDF.
[23] Conn. Gen. Statutes ch. 167, § 10-183g(h).
[24] S.B. 872: An Act Implementing the Governor's Budget Recommendations for General Government. Gen. Assembly. (Ct. 2019). https://www.cga.ct.gov/2019/TOB/s/pdf/2019SB-00872-R00-SB.PDF.
[25] S.B. 873: An Act Stabilizing the Teachers' Retirement Fund. Gen. Assembly. (Ct. 2019). https://www.cga.ct.gov/2019/TOB/s/pdf/2019SB-00873-R00-SB.PDF.
[26] Ibid.
[27] Ibid.

Figure 1 below displays the State of Connecticut's projected future ADECs for the TRS under three scenarios.[28] The first scenario (orange) is the current baseline (or current law), if the invested funds for the TRS achieve the current assumed rate of return (eight percent). The second scenario (blue) is the current baseline (or current law) if the invested funds for the TRS achieve a more realistic 6.9 percent return, which is the assumed rate of return for the SERS.[29] The third scenario (purple) is if the governor's proposed changes are implemented, and a 6.9 percent rate of return is realized.

If implemented, the governor's proposed changes are projected to mitigate the anticipated steep increase in the State's ADEC payments for the TRS until 2032 (the blue line in Figure 1).[30] However, such mitigation efforts require increased payments in the years following the steepest projected increase under the current baseline scenario. The proposed changes are projected to reduce the State's aggregate ADEC for the TRS by $6.6 billion in the years leading up to and including the highest projected ADEC under the current baseline (2032), assuming a 6.9 percent return.[31] After 2032, however, the governor's proposal is projected to require $22.2 billion in aggregate additional ADEC funding until 2049, an average of $1.3 billion per year, assuming a 6.9 percent return. In sum, the governor's proposal is projected to require a net increase of $15.6 billion in ADEC payments over the projected period (2020 to 2049).[32]

Figure 1[33]

Teachers' Retirement System (TRS) Projected ADEC ($000s)



[28] State of Connecticut, Office of Policy and Management. (2019). *Actuarial Projections for Governor Ned Lamont's Proposed Changes to Teachers' Retirement System*. Hartford, CT: Author. Retrieved from http://ctstatefinance.org/assets/uploads/files/Actuarial-Projections-for-Governor-Lamont-Proposed-TRS-Changes.xlsx.

[29] S.R. 51, July 2017 Special Session, Gen. Assembly. (Ct. 2017). https://www.cga.ct.gov/asp/cgabillstatus/cgabillstatus.asp?selBillType=Bill&which_year=2017&bill_num=sr+ 51

[30] State of Connecticut, Office of Policy and Management. (2019). *Actuarial Projections for Governor Ned Lamont's Proposed Changes to Teachers' Retirement System*. Hartford, CT: Author. Retrieved from http://ctstatefinance.org/assets/uploads/files/Actuarial-Projections-for-Governor-Lamont-Proposed-TRS-Changes.xlsx.

[31] Ibid.

[32] Ibid.

[33] Ibid.