Connecticut Pension Academy
An Introduction to Public Pensions

“State of Connecticut’s Public Pensions”

Presented by
Ed Koebel, EA, FCA, MAAA
Principal and Consulting Actuary
Cavanaugh Macdonald Consulting, LLC.
What is An Actuary?

- A person who passes as an expert on the basis of his prolific ability to produce an infinite variety of incomprehensible figures calculated with micrometric precision from the vaguest of assumptions based on debatable evidence from inconclusive data derived by a person of doubtful reliability for the sole purpose of confusing an already hopelessly befuddled group of persons who never read the statistics anyway.

- An actuary for a retirement plan calculates long-term liabilities of pension systems and how much money needed for funding the plan to maintain sustainability.
Connecticut Pension Plans

- Teachers’ Retirement System
- State Employees’ Retirement System
- Municipal Employees’ Retirement System
- Probate Judges and Employees Retirement System
- Judges, Family Support Magistrates and Compensation Commissioners Retirement System
Three Issues for all Public Sector Pension Plans

- Attraction and Retention
  - Compensation/Benefit Package
  - Competition with Private Sector

- Funding/Cash Flow
  - Baby boomer generation of retirees
  - Contribution holidays in past

- Actuarial Assumptions
  - Lower investment expectations
  - Mortality improvement
Pension Plan Policies

- Benefit policy
- Investment policy
- Funding policy
Benefit Policy

- How much, when and to whom are benefits paid?
- Typically established in statute or bargaining
- Limited actuarial role
What asset classes to invest in and in what proportion?

Typically driven by investment professionals

Actuarial role to assist with asset-liability modeling
Funding Policy

- How much and when to contribute?
- More necessary due to accounting requirements
- Typically driven by actuaries
Basic Retirement Funding Equation

\[ C + I = B + E \]

- **C** = Contributions
- **I** = Investment income
- **B** = Benefits paid
- **E** = Expenses (administration)
Basic Retirement Funding Equation

To ensure long term solvency the inflows must equal the outflows over the life of the program.

**INFLOW:**
- Employee Contributions
- Employer Contributions
- Investment Income

**OUTFLOW:**
- Benefit Payments
- Expenses
Funding Valuation Process

Present Value of Future Benefits (PVFB)

Actuarial Accrued Liability (AAL)

Future Normal Costs (NC)

Assets (AVA, MVA)

Unfunded Accrued Liability (UAL)

Member Portion

Employer Portion
Present Value

- The present value of an amount of money payable in the future is the amount of money that, if we had it today, would accumulate to the amount that will be payable considering:
  - Investment return
  - Probability that money will be paid
Example 1: You owe $1,000 to a financial institution payable one year from now. You estimate that you can invest money for a 7% return. What is the present value of the debt?

\[
\frac{1,000}{1.07} = \$934.58
\]

Observation: What if you’re mistaken about the 7%?
Example 2: You owe $1,000 to 100 people one year from now. Each person is 70 years old. You expect the same return (7%) and chance each person will be alive in one year (98%). What is the present value of the debt?

\[ 100 \times \frac{1,000}{1.07} \times 98\% = 91,589 \]

Observation: Under what circumstances will you have exactly enough money to pay the debt?
Volatility vs. Predictability

Market Value Return vs Proposed Assumptions

Return

-20.00%
-15.00%
-10.00%
-5.00%
0.00%
5.00%
10.00%
15.00%
20.00%
25.00%


-20.00%
-15.00%
-10.00%
-5.00%
0.00%
5.00%
10.00%
15.00%
20.00%
25.00%

Return

7.5%
7.0%
Connecticut Teachers

- Plan covers any teacher, principal, superintendent or supervisor in public schools or professional employees at State Schools, if chosen
- Each member contributes 7% of annual pay and is not covered by Social Security
- Benefit at Retirement
  - 2% of Final Average Salary (3) multiplied by credited service (maximum benefit of 75% of FAS)
- Eligibilities
  - Normal Ret: Age 60 and 20 or 35 years of service
  - Early Ret: 25 years of service or Age 55 and 20
  - Vesting: 10 years of service
- COLA based on CPI and partially dependent on investment performance of Fund (risk shared)
Connecticut Teachers
Historical Membership Data

<table>
<thead>
<tr>
<th>Year</th>
<th>Active Members</th>
<th>Retirees &amp; Beneficiaries</th>
<th>Actives to Retired Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>51,368</td>
<td>30,493</td>
<td>1.68</td>
</tr>
<tr>
<td>2012</td>
<td>49,808</td>
<td>32,294</td>
<td>1.54</td>
</tr>
<tr>
<td>2014</td>
<td>51,433</td>
<td>34,310</td>
<td>1.50</td>
</tr>
<tr>
<td>2016</td>
<td>50,877</td>
<td>36,065</td>
<td>1.41</td>
</tr>
<tr>
<td>2018</td>
<td>50,594</td>
<td>37,446</td>
<td>1.35</td>
</tr>
</tbody>
</table>
Connecticut Teachers
Historical Payroll vs Benefits

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Payroll</th>
<th>Total Benefits</th>
<th>Benefits as % of Payroll</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>$3,646</td>
<td>$1,365</td>
<td>37.4%</td>
</tr>
<tr>
<td>2012</td>
<td>$3,653</td>
<td>$1,531</td>
<td>41.9%</td>
</tr>
<tr>
<td>2014</td>
<td>$3,832</td>
<td>$1,696</td>
<td>44.3%</td>
</tr>
<tr>
<td>2016</td>
<td>$3,950</td>
<td>$1,832</td>
<td>46.4%</td>
</tr>
<tr>
<td>2018</td>
<td>$4,076</td>
<td>$1,951</td>
<td>47.9%</td>
</tr>
</tbody>
</table>
Connecticut Teachers Valuation Results

<table>
<thead>
<tr>
<th>Year</th>
<th>Actuarial Liability</th>
<th>Actuarial Assets</th>
<th>UAAL</th>
<th>Funded Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>$23,496</td>
<td>$14,430</td>
<td>$9,066</td>
<td>61.4%</td>
</tr>
<tr>
<td>2012</td>
<td>$24,862</td>
<td>$13,735</td>
<td>$11,127</td>
<td>55.2%</td>
</tr>
<tr>
<td>2014</td>
<td>$26,349</td>
<td>$15,547</td>
<td>$10,803</td>
<td>59.0%</td>
</tr>
<tr>
<td>2016</td>
<td>$29,860</td>
<td>$16,712</td>
<td>$13,148</td>
<td>56.0%</td>
</tr>
<tr>
<td>2018</td>
<td>$31,111</td>
<td>$17,952</td>
<td>$13,159</td>
<td>57.7%</td>
</tr>
</tbody>
</table>
Connecticut Teachers Contribution Rates

<table>
<thead>
<tr>
<th>Year</th>
<th>UAAL Amortization Rate</th>
<th>Employer Normal Cost Rate</th>
<th>Member Contributions</th>
<th>Total Contribution Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>15.09%</td>
<td>4.11%</td>
<td>6.00%</td>
<td>25.20%</td>
</tr>
<tr>
<td>2012</td>
<td>20.40%</td>
<td>3.73%</td>
<td>6.00%</td>
<td>30.13%</td>
</tr>
<tr>
<td>2014</td>
<td>19.92%</td>
<td>3.73%</td>
<td>6.00%</td>
<td>29.65%</td>
</tr>
<tr>
<td>2016</td>
<td>25.84%</td>
<td>3.60%</td>
<td>7.00%</td>
<td>36.44%</td>
</tr>
<tr>
<td>2018</td>
<td>27.50%</td>
<td>4.54%</td>
<td>6.00%</td>
<td>38.04%</td>
</tr>
</tbody>
</table>

* Members contribute 7% of salary but only 6% is used in determining employer contribution rate.
This projection is a deterministic projection from the 2018 valuation results and assumes contribution requirements continue to increase significantly to comply with the bond covenant in place at this time.
Established and mandated to develop and implement a plan to satisfy both the sustainability and affordability of TRS

Report completed in March, 2018

- Benefit Benchmarking
  - TRS provides a moderate level of retirement to its members compared to its peers
  - Adding TRS members to Social Security would greatly increase the cost per dollar of benefit
Report completed in March, 2018
  ▪ Current Plan Analysis
    – Stochastic model analysis indicates the benefit to TRS of reducing the assumed 8.0% assumption
    – Current bond covenant requires the State’s full funding of the ADEC but hamstrings the Plan to change assumptions used by other plans
    – Current return assumption is 8.0% but in this analysis, the median expected return of 7.0% is used.
Current return assumption is 8.0% but in this analysis the median expected return is 7.0%. Recurring investment losses are expected and result in increases to the expected ADEC.

The $0.2 billion possible state contribution in 2032 provided in the Boston College report is at the 18th Percentile of expected outcomes.
Funding Policy assumes that the ADEC is fully funded in all future years regardless of the amount, resulting in improved funded ratio.
Report completed in March, 2018
- Alternative Plan Analysis
  - Pension Obligation Bond Settlement
  - Change Funding Policy
  - Asset Transfer

Link to report:

Future studies on these alternative plans are currently being conducted throughout the State
Connecticut State Employees

- Plan covers all State employees, elected officials and their appointees
  - Tiered benefit plan based on Date of Hire
- Member contributions vary by Tier and by Class of employee, employees covered by Social Security
- Benefit at Retirement for New Tier IV members
  - 1.30% of Final Average Salary (5) multiplied by credited service
- Eligibilities for New Tier IV members
  - Normal Ret: Age 63 and 25 or Age 65 and 10
  - Early Ret: Age 58 and 10
  - Vesting: 10 years of service
- COLA for new retirees (post 2022)
  - Based on CPI but assumed rate of 1.95%
Connecticut SERS
Historical Membership Data

<table>
<thead>
<tr>
<th>Year</th>
<th>Actives</th>
<th>Retirees</th>
<th>Ratio</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>53,196</td>
<td>38,093</td>
<td>1.40</td>
</tr>
<tr>
<td>2010</td>
<td>50,064</td>
<td>41,782</td>
<td>1.20</td>
</tr>
<tr>
<td>2012</td>
<td>47,868</td>
<td>43,887</td>
<td>1.09</td>
</tr>
<tr>
<td>2014</td>
<td>49,976</td>
<td>45,803</td>
<td>1.09</td>
</tr>
<tr>
<td>2016</td>
<td>50,019</td>
<td>48,191</td>
<td>1.04</td>
</tr>
<tr>
<td>2018</td>
<td>49,153</td>
<td>50,441</td>
<td>0.97</td>
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</table>
Connecticut SERS
Historical Payroll vs Benefits

<table>
<thead>
<tr>
<th></th>
<th>Payroll</th>
<th>Benefit Payments</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>3,497</td>
<td>1,047</td>
</tr>
<tr>
<td>2010</td>
<td>3,296</td>
<td>1,264</td>
</tr>
<tr>
<td>2012</td>
<td>3,355</td>
<td>1,424</td>
</tr>
<tr>
<td>2014</td>
<td>3,488</td>
<td>1,577</td>
</tr>
<tr>
<td>2016</td>
<td>3,721</td>
<td>1,746</td>
</tr>
<tr>
<td>2018</td>
<td>3,428</td>
<td>1,931</td>
</tr>
</tbody>
</table>
## Connecticut SERS
### Amortization of UAAL

<table>
<thead>
<tr>
<th>Year</th>
<th>Initial UAAL</th>
<th>Remaining UAAL</th>
<th>Remaining Amortization Period (years)</th>
<th>Amortization Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statutory Base (1984 UAAL)</td>
<td>$4,138,969</td>
<td>$3,968,724</td>
<td>13</td>
<td>$414,929</td>
</tr>
<tr>
<td>2016 Base</td>
<td>16,248,400</td>
<td>16,683,862</td>
<td>28</td>
<td>1,083,777</td>
</tr>
<tr>
<td>2018 Base</td>
<td>570,349</td>
<td>570,349</td>
<td>25</td>
<td>39,265</td>
</tr>
<tr>
<td>Total UAAL</td>
<td>$21,222,935</td>
<td></td>
<td></td>
<td>$1,537,971</td>
</tr>
</tbody>
</table>

- **Annual Valuation Payroll**: $3,428,068
- **UAAL Amortization Rate**: 44.86%
Connecticut SERS
Projection of Plan

Connecticut SERS - Projection of Funded Ratio and Employer Contribution Requirement

Valuation Date (6/30)

- Employer Normal Cost
- Unfunded Accrued Liability Payment
- Funded Ratio
Plan covers municipalities that elected to provide a benefit to their departments
- Municipalities upon entry can elect and pay for past service for their employees
- Currently, there are 191 employers
- Mixture of General and Police/Fire Plans and With/Without Social Security (SS) Benefits
- Members contribute 5.00% if not covered in SS and 2.25% if covered by SS
- Benefit at Retirement
  - Not SS – 2% of FAS (3) multiplied by credited service
Connecticut Municipal

- Benefit at Retirement
  - SS – 1.5% of FAS (3) not in excess of year’s breakpoint (currently $74,000), plus 2.0% of FAS (3) in excess of breakpoint, multiplied by credited service

- Eligibilities at Retirement
  - Age 55 and 5 years of continuous service
  - 15 years of active aggregate service
  - 25 years of aggregate service
  - Compulsory retirement at age 65 for P&F members
  - Vesting – 5 years of continuous service

- COLA – CPI based with minimum annual COLA of 2.5%
Connecticut Municipal

- Last Valuation Completed was in 2016
- Membership:
  - Active members: 9,373
  - Annual Payroll: $566 Million
  - Retired members: 7,102
  - Annual benefits: $146 Million
- Funded Ratio of 86.1%
- Contribution Requirements (as a % of payroll)
  - General with SS: 11.74%
  - General without SS: 12.15%
  - Police and Fire with SS: 17.13%
  - Police and Fire without SS: 16.93%
Connecticut Municipal

- Experience Investigation of all actuarial assumptions completed in 2018
- Main recommendation was to lower investment return assumption from 8% to 7% to get in line with other State pension plans
- Will significantly increase contribution requirements for these municipalities
- 2018 Valuation report in the final stages and will be presented to Commission next week
Connecticut Judges

- State also covers plans for its Judges
  - Probate Judges and Employees (~ 500 members)
  - Judges, Family Support Magistrates and Compensation Commissioners (~ 870 members)

- Funded Ratios
  - PJERS: 84.8%
  - JFSMCCRS: 52.3%

- State contributions
  - PJERS: $4.4 Million for FYE 2019
  - JFSMCCRS: $27.0 Million for FYE 2019
Questions?

Ed Koebel, EA, FCA, MAAA
Principal and Consulting Actuary
Cavanaugh Macdonald Consulting, LLC.
Overview of Public Pension Issues and Trends

Keith Brainard
Research Director
National Association of State Retirement Administrators

Connecticut School Finance Project and
Connecticut League of Women Voters
Pension Academy: An Introduction to Public Pensions
January 2019
Presentation Overview

• The size and scope of public pensions in the US and Connecticut
• Public pension funding conditions
• Perspective on retirement plan design
• Trends and changes in public pension plan design
• Risk-sharing in public pension plan design
Public pensions in the U.S.

- ~$4 trillion in assets
- 14.5 million active (working) participants—employees of states and local government
  ▲ Nearly 10 percent of the nation’s workforce
- 10.7 million public pension retirees and their survivors receive ~$300 billion annually in benefits
- Annual contributions = $200 billion
  ▲ $145 billion from employers; $55 billion from employees
  ▲ Approximately 5.0 percent of all state and local government spending goes to public pensions
- Of 6,000+ public retirement systems, the largest 75 account for 80+ percent of assets and members

US Census Bureau, Public Fund Survey
Public pensions in Connecticut

• ~$44 billion in assets
• 127,000 active (working) participants—employees of states and local government
• 122,000 public pension retirees and their survivors receive ~$5 billion annually in benefits
• Annual contributions = $4.0 billion
  ▲ $3.4 billion from employers; $600 million from employees
  ▲ Approximately 6.8 percent of all state and local government spending goes to public pensions (FY 15)
• Of 212 public retirement systems, TRB and SERS account for 70+ percent of assets and members
• Slightly fewer than one-half of public employees in CT do not participate in Social Security
Comparison of Retirement Benefits in the U.S.

**Private Sector**

- 60% of full-time private sector workers participate in an employer-sponsored retirement plan; 21% of part-time workers participate
- In total, 49% of all private sector workers participate in an employer-sponsored retirement plan
- Fewer than one in five have a traditional pension (DB) plan
- Social Security coverage is universal

**Public Sector**

- Nearly all full-time workers have access to an employer-sponsored retirement benefit; most have access to a traditional pension (DB plan)
- 87% of full-time employees participate in a pension plan
- 80% of all employees, including part-time workers
- Virtually all others are in a DC plan
- Three-fourths participate in Social Security

US Bureau of Labor Statistics
Change in Aggregate Public Pension Funding Level, FY 01 to FY 17

Public Fund Survey
Nov-18

Public Plans Data
Median Change From Prior Year in Actuarial Value of Assets and Liabilities

Liabilities

Assets

Public Fund Survey
Nov-18

Fiscal Year
Distribution of Public Pension Funding Levels, FY 17

Median = 72.9%

Size of bubbles is roughly proportionate to size of plan liabilities

CT TRB

CT SERS

Public Fund Survey
Nov-18
Headwinds Facing Public Pension Plans

- Declining investment return assumptions
- Slow payroll growth as a result of
  - Sluggish hiring rates
  - Tepid salary growth
- Higher required pension plan costs
- Updated mortality assumptions to reflect longer life expectations
- Negative cash flow
Tailwinds Supporting Public Pension Plans

- Stronger employer efforts to pay contributions
- More aggressive liability amortization strategies:
  - More closed periods
  - Shorter periods
- Lower benefit levels = lower long-term costs
- Improving economy
- Slow improvement in hiring and salary growth
The typical public pension funding model is highly reliant on investment earnings.
Investment Return Assumptions, FY 01 to latest

- CT TRB: 8.0%
- CT SERS: 6.9%

Public Fund Survey, NASRA Jan-19
Relative Change in Employment in Private and Public Sectors, 2007 to present

U.S. Bureau of Labor Statistics
Change in Actives and Annuitants FY 01 to FY 17
Annualized Quarterly Change in Wage and Salary Costs for Private and State & Local Government Employees, 01-18

Data final as of Q2 2018

U.S. Bureau of Labor Statistics
Median Annual Change in Public Pension Payrolls, FY 02 to FY 17
NASRA’s Position on Pension Plan Design

• Core elements of public pension plan design:
  ▲ Mandatory participation
  ▲ Employee-employer cost sharing
  ▲ Assets that are pooled and professionally managed
  ▲ Targeted income replacement
  ▲ Annuitized benefits
  ▲ Survivor and disability benefits
  ▲ Access to a supplemental retirement savings plan
Perspective on Retirement Plan Design

• The purpose for providing a retirement plan is to meet stakeholder objectives

• Primary retirement plan stakeholders are public employers (school districts, police departments, state agencies, etc.), public employees, and taxpayers

• Stakeholder objectives:
  ▲ Employers seek to attract and retain qualified workers needed to perform essential public services
  ▲ Employees seek a competitive compensation package that includes a retirement benefit
  ▲ Taxpayers seek public services delivered in a cost-effective manner
Perspective on Retirement Plan Design

Q. Why not switch to a defined contribution plan as the primary retirement benefit?

A. A DC plan provides cost certainty and shields taxpayers from certain risks, but introduces new and different types of risk. Sound retirement plan design balances risks and rewards.

Q. What type of risks would a typical DC plan introduce?

▲ Among others:
▲ A DC plan can impair the ability of employers to retain workers, especially those who are older and experienced.
▲ A DC plan can impede the ability of workers to retire in a timely and orderly manner.
▲ A DC plan will result in some employees having no source of assured retirement income, which could mean they will rely on public assistance in their old age.
Perspective on Retirement Plan Design

• Multiple studies have concluded that a traditional pension benefit will deliver the same level of retirement income at a lower cost relative to alternative plan types.

• Generally, this is due to three factors:
  ▲ Pooled assets avoid “over-saving” by saving for the group rather than on an individual basis
  ▲ Lower investment and administrative costs
  ▲ Higher investment returns enabled by assets that are professionally managed and by maintaining a longer investment horizon

• See also
  ▲ “Pension Benefit Design Study, TRS of Texas,” 2018
  ▲ “Study of Colorado PERA Hybrid DB Plan,” 2015
  ▲ Plan Design@NASRA.org
Trends in Plan Design

• Reforms to pension plans since the 2008-09 market decline and the Great Recession are unprecedented in scope and magnitude

• Nearly every state has made changes to pension benefit levels, financing arrangements, or both

• Many states have enacted changes more than once

• Nearly all states have retained access to a traditional pension plan as employees’ primary retirement benefit
Changes to plan design typically are intended to accomplish one or more of the following objectives:

- Lower employer costs
- Reduce liabilities
- Reduce employer risk

The types of change, the degree of change, and who is affected vary widely among states and plans.

The effect on costs of changes in a pension plan design is heavily reliant on the groups that are affected by the changes.
Trends in Plan Design

- Reforms may affect new hires only, current active members, those already retired, or all three.
- Changes that affect new hires only tend to have limited effects on costs and liabilities.
- Changes that affect those already retired can have a significant effect on plan costs and liabilities.
- Public pension legal protections are a primary factor when considering changes to a pension plan.
- Legal protections run a wide range and are not always clearly known.
States That Have Increased Employee Contribution Rates
Median Employee and Employer Contribution Rates, FY 02 to FY 17

See also NASRA issue briefs on employee and employer contributions
States That Have Made Changes to Cost-of-Living Adjustment Provisions 2009-2018

Significant Reforms to State Retirement Systems, NASRA
Ways Pension Benefit Levels Have Been Reduced

- Lower retirement multiplier
- Longer period for calculating pensionable salary
- Higher required age to qualify for a full retirement benefit
- More required years of service to qualify for a full retirement benefit
- Lower rate of interest accrual on contribution account balances
States That Reduced Pension Benefits, 2009-2018
States That Implemented Automatic Risk-Sharing Features
2009-2018
States That Created New Hybrid Plans, 2009-2018

Plan Type
- Combination hybrid
- Cash balance
Statewide Hybrid Plans and Relative Participation Rates

See also NASRA issue brief on state hybrid retirement plans
Risk-Sharing Conceptually

\[ C + I = B + E \]

- Contributions plus Investment Earnings equals Benefits plus Expenses
- Over time, the revenue into a retirement plan must equal the plan’s expenses
- In a traditional defined benefit plan, when revenues are insufficient to pay for benefits, employer contribution rates rise
- Risk-sharing introduces the possibility that employee contributions or benefit levels will be adjusted
Conceptual Illustration of Typical Risk Distribution, by Plan Type

- **DB Plan, Employer Contributions Only**: More Employer Risk
- **DB Plan, EE and ER Contributions**: Cash balance plan, hybrid DB-DC plan, plans in which benefits or employee costs vary on the basis of such factors as investment performance and the financial or actuarial condition of the plan
- **Shared Risk**
- **DC Plan, EE and ER Contributions**: More Employee Risk
- **DC Plan, Employee Contributions Only**: More Employer Risk
Examples of Risk-Sharing Features

• **Hybrid plans**
  ▲ DB-DC: a traditional pension plan combined with a defined contribution plan
  ▲ Cash balance: a retirement benefit like a pension plan except the benefit is affected by investment experience and the employee’s retirement age

• **Variable employee contribution rates**, which can change based on the plan’s actuarial condition

• **Contingent benefits**, in which the size of the basic retirement benefit may be affected by the plan’s actuarial condition

• **Contingent COLAs**, the post-retirement benefit adjustment depends on some external factor, such as investment return or the plan’s funding level
Final Thoughts

• Public pension funding conditions range from strong and healthy to distressed

• In terms of scope and magnitude, an unprecedented number of changes to public pension plans have been enacted in the last decade

• Sound retirement plan design reflects the objectives of all stakeholder groups:
  ▲ Taxpayers, public employers, and public employees

• Most states have retained core features of sound retirement plan design while shifting some risk to employees
Thank you for listening!

With questions or to discuss public pension issues:

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www.nasra.org
Pension Academy: An Introduction to Public Pensions

The Legal Landscape of Pension Reform in Connecticut and Comparison States

Are Any Needed, Public Pension Reforms Legally Possible?

OR

Are Unbalanced Budgets, Deficits and Governmental Meltdown the Probable Result?

James E. Spiotto*
Managing Director
Chapman Strategic Advisors LLC
Co-Publisher Muninetguide.com
January 11, 2019

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   A. The transition of pensions from a gratuity (to be paid if you want) to a contractual right obligation (that is enforceable)  
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   C. The success of pension reform legislation and voluntary agreements and coming attractions  

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I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

A. The transition of pensions from a gratuity (to be paid if you want) to a contractual or property right obligation (that is enforceable):

1. Different approaches. States take different approaches in analyzing the pension rights of public employees and whether those rights can be modified.

2. Pensions as gratuities. Prior to the second half of the 1900's, pension payments were considered to be in the nature of a gratuity that could be reduced at will. Pension obligations were viewed as "pay as you go" since they were to be paid if there were funds and if the state or local government so desired.

I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

<table>
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I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

B. In most states, the constitutional, statutory and case law provisions determined pension obligations to be contractual obligations as opposed to property rights:

1. Contractual rights. Generally, state constitutional or statutory provisions provide that pension benefits are contractual rights. As will be noted herein, the contractual rights may be subject to the exercise of reasonable modifications and adjustments to pension benefits for a higher public purpose (health, safety and welfare of citizens), the exercise of police power:
   - A variation on the contract analysis is the California Rule which has been a stricter interpretation than a traditional contract clause. The California Rule requires any impairment to be offset by a comparable compensating advantage and also protects against prospective changes and generally benefits earned when first employed. As noted herein, there is presently pending cases in the California Supreme Court as to whether the California Rule should be clarified to require only reasonable pension benefits and not require the most optimum calculation of pension benefits?
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- Of the 35 states that have addressed whether modification of pension benefits violates the contract clause at least 14 have expressly rejected the California Rule on one or more elements and 19 other states have implicitly rejected one or more elements. Only two states, Nevada and Nebraska, appear to accept the entire California Rule.

2. **Property rights.** State statutory provisions regarding pensions may not be intended by the state legislature to be contractual in nature but rather a statement of the state's pension policy that is subject to reasonable modifications and changes by future legislative action. This results generally in the limited, vested rights of public employers to the pension fund for earned and vested benefits subject to reasonable modifications and protections against arbitrary legislative action under due process provisions of the state constitution. Six states have raised the issue of pension rights stating a property right as opposed to a contractual right (Wisconsin, Ohio, Maine, Connecticut, New Mexico and Wyoming).

3. **Impairment.** A non-impairment law is not intended to stretch pensions beyond their elastic limits. The question is raised if promised pension benefits realistically cannot be paid is adjustment to reality an impairment?
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

4. Developed public pension reform case law that permits modification of pensions. As circumstances change and available funds are stressed, pensions can be and need to be changed, but within certain parameters:

- Right to modify must be clear in legislation, employment agreements and union contract (Rhode Island).
- Adverse conditions which could lead to the failure of pension plan and the purpose of the legislation justify amendment (Vermont).
- To balance adverse consequence of actuarially necessary changes to strengthen or improve the pension plan (Colorado, West Virginia).
- Reasonable modifications that bear material relationship to theory of pension system and successful operation (Massachusetts).
- Certain legislation by its nature cannot bind successive legislatures and can be changed (Georgia).
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- Contractual pension rights may be altered if changes are related to maintaining a healthy pension system as a whole. Changes that disadvantage members must be accompanied by comparable new advantages (California Rule). The California Rule has been modified by appellate courts to a right to a reasonable pension subject to reasonable prospective modifications (*Marin Association of Public Employees v. Marin County Employee Retirement Association*, 08/17/16, California Court of Appeals First Appellate District hereinafter "Marin County Case". This case is now pending in the California Supreme Court.)

- Caps on cost of living increases or changes in percentages used for increases that cut the benefits were upheld in order to maintain the viability of the pension program (Minnesota, South Dakota, New Jersey, Kentucky and Colorado).
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

5. What can be adjusted. The non-impairment laws are not all-encompassing and generally have been held not to reach:
   - Benefits that accrue in the future.
   - Reduction in mandatory retirement age.
   - Reduction in hours or salary.
   - Loss of benefits for non-compliance with the plan.
   - Dismissal of public employee.

Even though such may indirectly affect the pension benefits received.
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

6. These principles in practice:
   - Changes to prevent pension plan from failing. Even states that find that their relevant contracts clauses prevent an impairment of pension rights typically hold that adverse conditions, which could lead to the failure of the pension plan and thus the purpose of the legislation itself, justify amendments to the plan.
   - Balancing advantages versus disadvantages of proposed modifications. Accordingly, in Colorado, a pension plan can be changed so long as any adverse modification is balanced by a corresponding change of a beneficial nature, a change that is actuarially necessary, or a change that strengthens or improves the pension plan. *McInerney v. Public Employees' Ret. Ass'n*, 976 P.2d 348, 352 (Colo. App. 1999).
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- Reasonable modification of pension in furtherance of the theory of the pension system. In Massachusetts, modifications to a state retirement scheme can be permitted so long as such modifications are reasonable and bear some material relationship to the theory of a pension system and its successful operation. *Madden v. Contributory Retirement Appeal Board*, 729 N.E.2d 1095 (Mass. 2000).

- Modification of pension must be related to an important public purpose. The courts of Vermont have found that, even if a party's contract rights have been impaired, the contract clause is only violated where the impairment is not reasonable and necessary to achieve an important public purpose. *Burlington Fire Fighters' Ass'n v. City of Burlington*, 543 A.2d 686 (Vt. 1988).
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- Does significant impairment reasonably relate to a justifiable public good. West Virginia has also adopted a balancing test holding that, where a substantial impairment has been shown and a legitimate public purpose for the impairment is demonstrated, a court must determine whether the adjustment of the rights and responsibilities of the contracting parties is based upon reasonable conditions and is of a character appropriate to the public purpose justifying the legislation adopted. State ex rel. West Virginia Regional Jail & Correctional Facility Auth. v. West Virginia Inv. Mgmt. Bd., 508 S.E.2d 130 (W.Va. 1998).
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- U.S. Supreme Court has recognized the need for contractual impairment to protect health, safety and welfare of local citizens ("Higher Public Purpose"). In the case of *Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942), the New Jersey Municipal Finance Act provided that a state agency could place a bankrupt local government into receivership. Under the law, similar to a Plan of Adjustment for a Chapter 9 municipal bankruptcy action, the interested parties could devise a plan that would be binding on nonconsenting creditors if a state court decided that the municipality could not otherwise pay its creditors and the plan was in the best interest of all creditors. *Id.* at 504. After certain bondholders dissented, the court determined that the plan helped the city meet its obligations more effectively. *Id.* "The necessity compelled by unexpected financial conditions to modify an original arrangement for discharging a city's debt is implied in every such obligation for the very reason that thereby the obligation is discharged, not impaired." *Id.* at 511. The court then found that the plan protected creditors and was not in violation of the Contract Clause. *Id.* at 513. See also *U.S. Trust v. New Jersey*, 431 U.S. 1, 25-28 (1997).
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- This precedent has been used to justify pension reform. The Supreme Court of Puerto Rico has ruled (citing the U.S. Trust v. New Jersey case) that the protection of pension obligations is not absolute but may be modified if reasonable and necessary to advance an important public interest, namely a financial crisis that threatens the actuarial solvency of the pension system. *Hernandez v. Commonwealth*, 2013 WL 3586616. (S. Ct. Puerto Rico, June 24, 2013).

I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

C. The success of pension reform legislation and voluntary agreements and coming attractions:

1. State and local government pension funds status:
   - Approximately 4,000 public sector retirement systems for state and local governments in the United States with $3.8 trillion in assets, 14.4 million current employees, 9 million retirees and annual aggregate benefit distributions of $228.5 billion.
   - The amount of pension underfunding for states and local governments is estimated to range between $1 to $3 trillion.
   - This unfunded liability for pensions can be compared to the estimated FY2016 revenue of $3.3 trillion for state and local governments.
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- A recent national survey of 168 leading state and local government credit analysts asked "What do you think are the five most important issues/trends facing the municipal bond market right now [March 2018]? Ninety-two percent responded, "public pension funding levels, pension obligation bonds." See PNC, U.S. Municipal Bond Market, Municipal Bond Analyst Survey 2018 (April 5, 2018), Thomas Kozik.

- In October 2018, The Center for Retirement Research at Boston College Report noted:
  - The average funded ratio between 2001-2017 demonstrates:
    - The top third funded pension funds were 110% funded on average in 2001 compared to 90% in 2017, a 20% drop.
    - The middle third pension funds were 100% funded on average in 2001 compared to 73% in 2017, a 27% drop.
    - The bottom third pension funds were 90% funded on average in 2001 compared to 55% in 2017, a 35% drop.
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- Between March 2000 to October 2002, the S&P 500 lost 49.1% in value and between October 2007 to March 2009, the S&P 500 lost 56.4% in value.
- Is pension underfunding caused more by the lack of adequate funding or by losses on investments given economic downturns?
- It is interesting to note that the Connecticut's SERS in 2001 had a funding ratio of 63% which fell to 41% in 2010, or a reduction of 35% since 2001 that fell to a 36% funding ratio in 2016, or a reduction of 42% of the funding ratio from 2001.

2. Many state and local governments have no current pension fund problem or have resolved it: It should be noted that a number of states (see e.g., Wisconsin, Tennessee, South Dakota, Utah, Alaska, North Dakota) and local governments (Washington D.C., Denver, Scottsdale, Indianapolis, Raleigh) have or will successfully address public pension issues without extensive prolonged disputes or litigation.
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

3. The aging population and possible future economic downturn are reasons to be vigilant no matter the current conditions of the pension fund: Those over 65 years of age in the United States constitute an increasing percent of the population, namely 14.8% of the 2015 population, which percentage is expected to grow to 20.9% by 2050. Likewise, the working years of 18-64 of age are expected to be reduced as a percent of population, namely from 62.2% in 2015 to 57.6% in 2050. This results in about 40 million more people over 65 as potential retirees.

While the USA percentage of population over 65 may be lower than many other developed countries in 2050, such as Europe at 26%, China at 24% and Japan at 33%, it is still a concern. Likewise there have been 11 economic downturns since 1949, about one every 7 to 10 years, so we now are facing the probability of an economic downturn in the next few years since the last downturn was 2008. Economic downturns result in losses on pension fund investments and less revenues available to state and local governments to address the issues.
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

4. Recent pension reform and litigation: Between 2010 and 2016, over 45 states have addressed pension reform. To date, since 2011, there have been over 24 major state court decisions dealing with pension reforms by state and local governments.

Over 80% (20 out of 24) of those decisions affirmed the pension reform, which covered reduction of benefits, including COLA, or increase of employee contributions, as necessary, and many times citing the Higher Public Purpose of assuring funds for essential governmental services and infrastructures. Of the four states that did not approve the pension reform, two states, Oregon and Montana, cited the failure of the proponents of reform to prove a balancing of equities in favor of reform for a Higher Public Purpose. Another state, Arizona, included state court judges in the reform, which violated other constitutional provisions about improper influence over judicial officers during service. The recent Illinois Supreme Court rulings appear to stand singularly against pension reform for a Higher Public Purpose or as a reasonable effort to save an insolvent pension system.
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

5. Examples of recent pension reforms and pension reform litigation:
   - California: California's Pension Reform of 2012 estimated savings of between $42 billion - $55 billion for CalPERs and $27.7 billion for CALSTRs.
   - Rhode Island: Rhode Island's Pension Reform and Interim Suspension of COLA, created hybrid pension plans for non-public safety employees and increased the minimum retirement age. The dispute over this reform was originally settled, but then the police union rejected the proposed settlement. Ultimately, there was a settlement of the litigation, and the reforms were implemented with some settlement adjustments.
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- **COLA litigation**: COLA litigation has resulted in eliminating or reducing COLA in Maine, Minnesota, New Jersey, Rhode Island, South Dakota, Colorado and others. The Arizona Supreme Court case of February, 2014 was an aberration because judges were included in the reform, and, traditionally, judges' salaries cannot be affected while they are sitting. However, there was a pension reform for Arizona public safety officers lead by the firefighters and police representative which was approved by the legislature and supported by a favorable vote on a constitutional amendment regarding pension reform for public safety workers statewide based on a consensual agreement, *inter alia*, to changes to existing pension benefit enhancement to COLA reduction reforms similar to that already done in other states. The Illinois Supreme Court has ruled efforts to reduce COLA benefits for current employees violates the Illinois Constitutional Pension Clause.
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- Successful Illinois pension reform: Illinois Pension Legislation of 2010 for new employees as of January 1, 2011 was not seriously challenged and is effective. This created tier II for new employees with reduced pension benefits.

- There were two cases in federal court supporting pension reform in Lexington, Kentucky and Chattanooga, Tennessee which included COLA reform. See Tom Puckett, Roger M. Vance et al., Plaintiffs-Appellants vs. Lexington-Fayette Urban County Government et. al.; Commonwealth of Kentucky, Defendants-Appellees, Case No. 156097, United States Court of Appeals for the Sixth Circuit, August 15, 2016 ("Lexington Case"); John H. Frazier, Reuben K. Salter, William Melhorn, Jr., James Gaston, Plaintiffs-Appellants vs. City of Chattanooga, Tennessee; Chattanooga Fire and Police Pension Fund, Defendants-Appellees, United States Court of Appeals for the Sixth Circuit, Case No. 15-6405, November 3, 2016 ("Chattanooga Case").
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- Illinois pension reform declared unconstitutional:
  - Illinois pension reform legislation in 2013, providing a claimed $160 billion in savings over a 30-year period, was struck down by the Illinois Supreme Court as unconstitutional in the case of *In re Pension Reform Litigation* (Ill. Supreme Court, May 8, 2015, hereinafter "Illinois State Pension Reform Case").
  - The Illinois Supreme Court held the reform legislation was unconstitutional under the pension protection clause of the Illinois Constitution Art. XIII §5 (hereinafter "Pension Protection Clause") whereby, according to the Illinois court, benefits accrue to the public worker once an individual begins work and becomes a member of a public retirement system, and those contractual provisions cannot be impaired or diminished even in the face of an important public purpose argument.
  - The court held that there could be no exercise of police power to disregard the express provision of the Pension Protection Clause, and the failure of the legislature to act consistent with the Pension Protection Clause in the face of the well-known need for funding of the unfunded pension obligations undermines the police power argument.
Chicago pension reform denied:

- City of Chicago Labor Pension Reform litigation involving public laborers and workers (Ill. Supreme Court, March 24, 2016, hereinafter "City of Chicago Pension Reform Case") resulted in the Illinois Supreme Court ruling that the reforms were unconstitutional as a violation of Pension Protection Clause for the reasons set forth in the Illinois State Pension Reform case.

- The court further found that the alleged consideration for the modification was already required funding and not sufficient to justify the change in benefits.

- Further, the Illinois Supreme Court ruled that Section 22-403 of the Illinois Pension Code in effect prior to 1970, which provided that the State of Illinois and City of Chicago were not obligated to fund more than the statutory required payment that the City had consistently funded, was superseded by the Pension Protection Clause.

- The Supreme Court, at the same time, recognized the timing and amount of funding the pension obligation was a legislative power of the city that the court could not then order or interfere with, and it was up to the city to decide the time and amount of funding.
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- **San Jose and San Diego attempts**: San Jose, San Diego and other cities have sought pension reform. San Jose's pension reform litigation recognized that pensions could be adjusted but, despite a 70% referendum, the court struck down portions of legislation as violating vested rights of workers. However, the court also recognized the City of San Jose's right and power to reduce salaries prospectively and to fire or lay off employees.

- **Austerity versus reform**: Some cities since 2007 have resorted to layoffs, furloughs, reduction in workforce and deferred preventive maintenance and infrastructure to deal with any issues related to insufficient funds to pay expenses including costs of labor and pension benefits.
I. Can Unaffordable Pension Benefits Be Enforced, Rolled Back, Reduced or Changed?

- Arizona public safety workers constitutional amendment: The public safety officers along with local government and others recognized that Public Safety Personnel Retirement System ("PSPRS") financial health had significantly deteriorated over the last 12 years. Pension benefit increases ("PBI") had been received in full over last 20 years while there had been continued decline in PSPRS funding. (The Plan's funding ratio declined from 142% in 2000 to 67% in 2010 to 48% in 2015 funded). The historic trend in valued returns had been 5% or less since 2002 while the rate of return for valuation purposes was 8% and recently reduced to 7.5%. Annual pension costs had significantly increased to a level that pension debt threatened the continued delivery of public services and budgets for many local governments. As noted above, in 2014, the Arizona Supreme Court struck down efforts at pension reform. Recognizing the financial distress caused by ever increasing pension costs as well as unfunded liabilities, the public safety workers, state legislators and local government employers built a consensus for the need for constructive reform. The reform replaces uncertain inequitable and unsustainable COLA payments with COLA payments based on the consumer price index for Phoenix region with a cap of 2% maximum.
Further, COLA will be prefunded and actuarially accounted for as part of normal cash determination. This was accomplished through a constitutional amendment (Proposition 124) supported by public safety officers, representatives, state elected officials and local governments. The constitutional amendment passed a vote of the electorate in May, 2016. In addition, an entirely new retirement plan was developed for new employees. Further, the legislation, S.B 1428, enacted significant governance reform. It is anticipated that these pension reforms will save between 20% and 43% in normal cost of retirement for each new hire. The reform will reduce future accrual of PSPRS pension liabilities by at least 36%, reduce taxpayer exposure to future market risk by more than 50% and reduce validity in employer contribution rates by more than 50%.
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

A. The Contract Clause of the United States Constitution does not prevent the exercise of police power:

1. In a government contractual relationship and in the enactment and provisions of state legislation, the government does not surrender essential governmental powers: For nearly 200 years, the United States Supreme Court has held that legislatures lack the power to "surrende[r] an essential attribute of [their] sovereignty" or "bargain away the police power of a State" U.S. Trust Co. of N.Y. v. New Jersey, 431 U.S. 1, 23 (1977) (quoting Stone v. Mississippi, 101 U.S. 814, 817 (1880)). As the U.S. Supreme Court explained in Butchers' Union Slaughter-House & Live-Stock Landing Co. v. Crescent City Live-Stock Landing & Slaughter-House Co., 111 U.S. 746, 751 (1884), "[t]he preservation of [the public health and morals] is so necessary to the best interests of social organization, that a wise policy forbids the legislative body to divest itself of the power to enact laws for the preservation of health and the repression of crime."

2. The police power is paramount to any contractual or legislative granted right and there is the implied reservation of the rights of government.
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

B. The United States Supreme Court recognizes balancing of interests as applied to the Contract Clause and legislative enactments:

1. *Homebuilding & Loan Ass'n v. Blaisdell*, 290 U.S. 398 (1934) ("Blaisdell"), the United States Supreme Court upheld the Minnesota Mortgage Foreclosure Moratorium Law as a valid exercise of the police power, noting that the constitutional protection against the abrogation of contracts was qualified by the authority the state possesses to safeguard the vital interests of its people and that the legislature cannot bargain away the public health or the public morals.

2. Further, the economic interests of the state may justify the exercise of its continuing and dominant protective power notwithstanding any interference with contracts.
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

3. Importantly for this analysis, the *Blaisdell* court noted that there needs to be a *rational compromise* between individual rights and the public welfare: It articulated the conditions that justify interference with contractual rights, including: (1) an emergency is present, (2) the legislation is addressed to a legitimate end, (3) the relief afforded is of a character appropriate to the emergency and (4) the conditions do not appear to be unreasonable. *Id.* at 444.

4. U.S. Supreme Court cases support impairment of pension benefits for a Higher Public Purpose – General welfare of citizens: The wisdom of the above-cited United States Supreme Court cases should reinforce the appropriate interpretation of the public pension legislation and constitution provisions that unaffordable pension benefits whose funding would interfere with the appropriate funding of governmental services and infrastructure must be reasonably adjusted for the sake of all concerned.
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

C. Current pension obligations of the state and certain local governments raise questions of whether they are sustainable and affordable and threaten the provision of essential services and needed infrastructure improvements. There has been valuable work done on the viability and affordability of Connecticut pension benefits to public workers. Such efforts include among others:


II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services


Various calculation of pension obligations and funding levels may vary by the assumptions used. Rather than looking for definitive accuracy, the directional trends and general levels of funding are what is significant.
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

1. State of Connecticut and its major cities retirement benefits and bonded debt: The Manhattan Institute's June 2018 Study made the following findings:

<table>
<thead>
<tr>
<th>Connecticut State and Major City Retirement Benefits and Bonded Debt</th>
<th>Bridgeport</th>
<th>Hartford</th>
<th>New Haven</th>
<th>Stamford</th>
<th>Waterbury</th>
<th>Connecticut</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population</td>
<td>147,022</td>
<td>124,320</td>
<td>130,405</td>
<td>127,410</td>
<td>109,211</td>
<td>3,581,570</td>
</tr>
<tr>
<td>Net Pension Liability</td>
<td>$901,411,149</td>
<td>$428,476,000</td>
<td>$777,124,011</td>
<td>$173,774,375</td>
<td>$222,364,000</td>
<td>$37,192,071,000</td>
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<tr>
<td>Outstanding Pension Obligation Bonds</td>
<td>$244,040,000</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>NA</td>
<td>$2,273,082,000</td>
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<tr>
<td>Unfunded Retiree Health-Care Liability</td>
<td>$804,740,932</td>
<td>$265,190,000</td>
<td>$556,890,000</td>
<td>$250,500,000</td>
<td>$894,014,000</td>
<td>$2,888,580,000</td>
</tr>
<tr>
<td>Total Retirement Benefit Liability</td>
<td>$1,650,151,111</td>
<td>$793,669,000</td>
<td>$1,324,013,311</td>
<td>$420,364,375</td>
<td>$1,371,443,000</td>
<td>$61,294,063,000</td>
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<tr>
<td>Outstanding Primary Government Debt</td>
<td>$442,372,000</td>
<td>$622,327,000</td>
<td>$659,015,000</td>
<td>$555,614,000</td>
<td>$200,074,000</td>
<td>$22,875,827,000</td>
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<tr>
<td>Per-Capita Net Pension Liability</td>
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<td>$5,050</td>
<td>$4,003</td>
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<td>Per-Capita Unfunded Retiree Health-Care Liability</td>
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<td>$2,374</td>
<td>$4,370</td>
<td>$1,967</td>
<td>$9,166</td>
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<td>Per-Capita Retirement Benefit Liability</td>
<td>$9,054</td>
<td>$5,021</td>
<td>$10,230</td>
<td>$3,370</td>
<td>$10,222</td>
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<td>Per-Capita Primary Government Debt</td>
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<td>$8,408</td>
<td>$4,000</td>
<td>$4,361</td>
<td>$1,032</td>
<td>$6,375</td>
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</table>

Source: Stephen D. Eide, Manhattan Institute June 2018 Connecticut City Pensions: The Affordability Gap
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

- Total per capita pension and health care liability GAP for State of Connecticut (not including local governments) is $16,463.
- State and local combined per capita pension and health care liability GAP:

For each resident of:

<table>
<thead>
<tr>
<th></th>
<th>PER CAPITA LOCAL GOVERNMENT PENSION AND HEALTH OBLIGATIONS</th>
<th>PER CAPITA LOCAL GOVERNMENT DEBT</th>
<th>PER CAPITA STATE DEBT, PENSION AND HEALTH OBLIGATIONS</th>
<th>PER CAPITA TOTAL STATE AND LOCAL PENSION, HEALTH AND DEBT OBLIGATIONS</th>
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<td>Bridgeport $26,027</td>
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<td>5.</td>
<td>Waterbury $26,685</td>
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<td>$51,354</td>
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</table>
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

Source: Stephen D. Eide, Manhattan Institute, June 2018

Connecticut City Pensions: The Affordability Gap

Source: Stephen D. Eide, Manhattan Institute, June 2018 Connecticut City Pensions: The Affordability Gap
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

2. **State stress test results**: PEW Charitable Trust Study Assessing the Risk of Fiscal Distress for Public Pension State Street Tech Analysis in May of 2018 noted:

   - Connecticut, like a number of other states over a decade ago instituted the laudable practice of making each year 100% of the Actuarial Required Contribution (ARC) / Actuarial Determined Employer Contribution (ADEC) and in 2017 adopted a hybrid plan for state workers.
   - PEW’s stress test showed the 100% funding of the ARC / ADEC for over a decade help in staving off the possible current insolvency of pension funds.
   - PEW notes if state funding policy was fixed at a 5% funding policy (more conservative than current policy but maybe more reflective of current market conditions) the required contribution rate is projected to reach 80% of payroll of 2032 from less than half of that in 2018.
   - PEW raises the concern that adherence to such a funding schedule is highly unlikely to be sustainable.
3. **Do public pension obligations demand too large a percentage of the State of Connecticut’s General Fund?**

   - Michael Cembalest of J.P. Morgan Asset Management, in his 2018 Report, calculated that approximately 36% of Connecticut’s state revenue collected over the next 30-year period would be required to pay (a) interest on bonded debt, and the state’s share of (b) defined benefit plan actuarial required contributions (ARC), (c) retiree health care costs, and (d) defined contribution plan expenses with level payments and a 6% pension investment return.

   - This is a clear demonstration of crowding out needed funding of governmental services.

   - Only twelve other states have 15% or more of state revenues collected being used for pension-related obligations, and only six states, including Connecticut, are above 25%. Illinois had the highest percentage of revenues collected required to pay pension underfunding obligations at approximately 51% of state revenues collected over a 30-year period.
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

D. If needed pension reforms proposal in Connecticut fail or appear to be impossible, does it mean that public pension contractual obligations cannot be altered and the state and various local governments will suffer unbalanced budgets, deficits and the inability to fund necessary governmental services and infrastructure improvements? No, that is not necessarily the result:

1. The essential mission of government is to provide needed governmental services and infrastructure improvements at an acceptable level for the health, safety and welfare of its citizens.

2. The U.S. Supreme Court rulings permit impairment of contracts for a Higher Public Purpose such as modifying public pension contracts for the public health, safety and welfare of citizens and to allow sufficient funds to pay for needed essential services and infrastructure improvements.
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

3. There are at least four possible alternatives available to state and local governments who face this serious problem of needed pension reform. These alternatives assume that all traditional pension reform efforts have been explored including raising taxes and reducing expenditures to the extent possible and needed pension plan adjustments and modifications appear to be impossible legally or on a consensual basis. The four alternatives to be considered by the state or local government employees are:

(A) Prepackaged Chapter 9 plan of debt adjustment, which requires state authorization to file Chapter 9, and in Connecticut, the municipality must obtain the express written consent of the governor to file a Chapter 9 proceeding. If the governor consents, the governor shall submit a report to the state treasurer and general assembly committee on matters relating to finance, revenues and bonding setting forth the reason for consent.
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

(B) **Creation of a special federal bankruptcy court for insolvent public pension funds** (which requires federal legislation to be enacted).

(C) **Government Oversight, Refinance and Debt Adjustment Commission ("GORDAC")** to assist where public pension reform is otherwise legally or practically impossible (which is somewhat similar to the Municipal Accountability Review Board ("MARB") passed in Connecticut in 2017).

(D) **Model Guidelines for a state constitutional amendment or legislative public pension funding policy** for a higher public good: the necessity of pension benefits adjustment for the public safety and welfare in those situations where state constitutions, statutes or case law appear to prohibit any impairment or reduction of pension benefits.
II. The United States Supreme Court Has Consistently Ruled That States Cannot Abdicate Their Inalienable Governmental Power to Provide Essential Governmental Services

4. Model Guidelines for a state constitution amendment or legislative public pension funding policy for a Higher Public Purpose appear to be a reasonable solution since Chapter 9 state authorization to file Chapter 9 legislation with governor consent is rare (only two Chapter 9 filings in the last 38 years in Connecticut), GORDAC is similar to MARB legislation and a federal bankruptcy court for public pension funds is dependent on the United States Congress to enact a law.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

A. Statutory basis of protection of public employees pension benefits under Connecticut law:

1. No constitutional protection: There is no explicitly constitutional protection for public pension benefits under Connecticut law.

2. State statute no contract rights: The Supreme Court of Connecticut in *Pineman vs. Oechslin*, 488 A.2d 803, 195 Conn. 405 (1985) recognized that the State Employees Retirement Act should be interpreted as not containing express language indicating an intent to create a contractual rights of the public employee to pension benefits. Without expressed statutory language, the legislature cannot be deemed to create a contract right.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

3. **Public employees have a property right to pension benefits**: Statutory language does provide protection of vested pension benefits for employees who have satisfied eligibility requirements by becoming eligible to receive benefits. Connecticut courts have recognized that the state statutory pension scheme establishes a property interest of the public employees in vested pension benefits entitled to be received which is a protection from arbitrary legislative action under due process provision of the state constitution. See *Pineman, supra*. 
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

4. Statutory protection for municipal employees: Section 7-450(a) of Ct. General Stat. provides that any municipality or subdivision thereof may establish pension, retirement or other past employment health and life benefit systems or amend any special act concerning such benefit systems for the maintenance in sound condition of such pension, retirement or past employment health benefit system provided the right or benefits granted to individual members shall not be diminished or eliminated. Following the ruling in Pineman and other Connecticut courts, the expressed legislature interest is not to create a contract right but a property to right to pension benefits upon becoming eligible to receive them and recognized reasonable modification and change for the benefit and soundness of the retirement system.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

B. Understanding the *Pineman* decision and its application to protection of public pension benefits and the ability to make reasonable and needed adjustment to unsustainable benefits:

1. Recognition of legislative policy enacted into legislation is subject to reasonable and needed changes: It is well recognized by the U.S. Supreme Court that the principal function of a state legislative body is to make laws that declare the policy of the state and that are subject to change when subsequent legislature shall determine to alter the policy *Dodge v. Board of Education*, 302 U.S. 74, 78-79 (1937); *Indiana ex rel. Anderson v. Brand*, 363 U.S. 95, 100 (1938). This is the recognized principle as to public policy that a state legislative body cannot bind a subsequent state legislative body.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

2. Statutory contractual rights can only exist if expressly so stated in the legislation: Absent a clear statement of legislative interest (expressed language), there is a well-established presumption against finding a statute creates private vested contractual rights. Pineman, supra; Wilson v. East Bridgeport School District, 36 Conn. 230, 282 (1869). There can be no constraints on a state legislature to modify or change a state public policy as may be deemed necessary to the legislature.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

3. Other states characterizing public pension benefit rights as contractual rights conflicts with traditional legislative prerogative to reserve to the legislature the implicit power of statutory amendment and modification: There is a legal tension between final statutory pension plans giving rise to contractual rights and the practical and legislative requirements of permitting unilateral modifications of the pension contracts as deemed reasonable and necessary. To provide employees contractual rights to public pension benefits and also maintain that necessary and reasonable unilateral pension modification can be made by the government employer defies the basis contract law tenet that requires mutual assent. See *Pineman*, supra; *La Boc Bus Corporation v. Larefield*, 365 A.2d 1066 (1976). Further claiming the state has the ability to rewrite its own public pension contract stresses the notion of judicial review. However, the police power ability of legislature to modify statutes and contracts for a higher public purpose, namely the protection of the health, safety and welfare of citizens, cannot be surrendered or limited by any government legislative acts. See *United States Trust Co. of N.Y. v. New Jersey*, 431 U.S. 1, 23 (1927); *Stone v. Mississippi*, 101 U.S. 814 (1880). See also the beginning of this Section III herein regarding the U.S. Supreme Court decision that states cannot abdicate power to provide for essential governmental services. If unsustainable public pension benefits are unaffordable and crowd out funding of essential government services (public safety, education, transportation, water and waste service, etc.) the state and local government must adjust such benefits for the health, safety and welfare of all. To do otherwise would frustrate the very purpose of governments. A state's legislature must be free to exercise its constitutional authority for a higher public good without concern that each time public policy is expressed, contractual rights are created. Accordingly, a property right to the pension fund or pension benefits when eligible to receive them.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

4. Due process and the limitation to make only reasonable and necessary adjustments for the soundness of pension benefits system is part of the property right and pension benefits analysis: In states where pension expectations are determined to be property rights statutory changes to pension benefits will be upheld if they have a legitimate purpose, and are reasonable and foster the purpose of pension benefits. Traditional notion of due process by reasonable and necessary modification and restriction on purely arbitrary revisions. See Pineman, 488 at 810; Connecticut Education Assn. v. Terozzi, 210 Conn. 286, 299 (1989). This means the legislature must show relationship to financial health. The due process protection against arbitrary change to pension benefits provides the flexibility to make needed changes for property right states in contrast to the challenges to such changes the contract rights states struggle with.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

5. The taking clause should not limit the ability of government employers to make reasonable and needed changes to pension benefits that are determined to be property rights: The Pineman case provides that pension protection extends only to the vested property right to pension benefits that an employee is eligible to secure and does not raise taking clause issues (taking property without just compensation) to adjustments to pension benefits that are prospective or changes to legislative policy for pensions that are reasonable and necessary. First, since legislative policy can be changed by the legislature, changes to future pension benefits are not a taking since no property has been earned or taken. Generally, under state law, the government employer reserves the right to hire, fire, change the nature of the work assigned and the timing of services to be delivered, the amount of compensation and position or title held. According future compensation, continued employment, nature of tasks to be performed, etc., and pension benefits based thereon can be modified or changed without raising a taking issue.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

C. Number of state courts recognized the lack of a contract may even foreclose a taking clause: The courts seem to look to reasonableness and necessity of such adjustments for the soundness of the pension system and whether the employees have current right to the benefit being modified.

D. Reasonable and necessary adjustment to unsustainable or unaffordable public pension benefits by the government employer may be permitted under Connecticut law:

1. In order to be a vested property right the employee must be eligible under current state law to receive the benefit: The State of Connecticut may change pension policy prospectively or for unearned benefits so long as the changes are reasonable and deemed necessary in the exercise of the state's governmental affairs.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

- In 1992, the state changed the Cost of Living Adjustment ("COLA") eligibility requirement and the amount on prospective basis (Public Act 92-205).

- In *Levine v. State Teachers Retirement Board*, 1998 Ct. Super. LEXIS 233 (Conn. Super. Ct. 1998) the court ruled that the prospective changes to COLA amount and eligibility requirements were reasonable and permitted and did not violate the rights of the employer.

- That court cited *Pineman* to the effect: there was no clear statement from the legislature that it created a contract with the plaintiff employees as to a specific amount so there is no violation of any constitutional guaranteed contractual rights.
II. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

2. State and local government requirement for a balanced budget or capped budget supports reasonable needed adjustments of unaffordable pension benefits: The Connecticut Constitution (Article XXVIII) required the state to have a "balanced budget", namely, "the amount of general budget expenditures for any fiscal year shall not exceed the estimated amount of revenues for such fiscal year." There are also limits or caps on increases in general fund expenditures for any fiscal year compared to the prior year and the percentage increase in personal income or inflation. Likewise, under Connecticut Statutes, including establishing the creation in 2017 of Municipal Accountability Review Board (MARB) to provide financial discipline and avoiding budget deficits.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

3. Why balanced budgets benefit pension beneficiaries: In the late 1980's, it was in part the inability of Bridgeport to balance its budgets, though it attempted to increase taxes and cut expenditures, that resulted in the 1991 Chapter 9 bankruptcy filing. Generally, raising taxes and cutting services by reducing expenditures causes individual and corporate tax payers to leave which generally results in less revenues being collected and can initiate a death spiral if the systemic cause of financial distress in not addressed. The failure to fund essential governmental services in order to fund unsustainable pensions benefits can be fatal to the municipality's ability to generate sufficient revenues to continue certain public employees to be employed. Further, in this situation, revenues available to pay pension obligations would in all events be less. Crowding out the funding of essential services can result in a death spiral. The pressure of the "balanced budget" and the need to fund essential services illustrate the need to address fiscal distress and pension affordability issues.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

4. Court limitations on ability to order government (legislature) to appropriate funds for pension payments: Due to the separation of power into legislative, executive and judicial, there has been in virtually all states court rulings that absent inability to make current pension benefit payments to retirees or declared pension fund insolvency, courts cannot interfere with the legislative discretion as to the timing of the legislature to appropriate funds for and the amount of payment of pension obligations. See Massameno v. State Grievance Committee, 234 Conn. 539 (1995).
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

5. **The dynamic uncertainty of the extent pension benefits can be adjusted may facilitate consensual resolution:** Given the issues of what is reasonable and necessary and to what degree pension benefits are fully vested and are not subject to legislative policy adjustment or elimination can be areas of dispute. It is clear, the property rights analysis of pension benefits combined with the ability to make pension policy amendments to statutory pension laws (since they are not vested contractual rights) provides Connecticut government employers with more leverage in negotiation of needed reforms to pension benefits. The property rights of eligible workers provide public workers with a base level of benefit that should not be eroded. Since consensual resolution is always preferred and the best alternative, the legislative flexibility provided by *Pineman* and its progeny appears to be preferable to constitutional or statutory contractual analysis that has lead to gridlock in Illinois, New Jersey, Kentucky and elsewhere.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

6. Some basic principles of reasonable and needed changes to public pension policy and benefits: It should be obvious that the only time there is a need for pension reform is due to the unsustainability and unaffordability of pension obligations. The inability to pay can be understood. The unwillingness to pay (when there is financial ability to do so) cannot be understood or accepted. Further, the proposed pension reform should be premised for the most part on the need for financial soundness of the pension system (including transgenerational fairness to younger workers) and the financial survival of the government in providing essential services to its citizens at an acceptable level. Accordingly, changes in retirement age (Pineman), modification of COLA payments (Levine) are examples of prospective changes for the financial health and uniformity of benefits to pension beneficiaries. Likewise, prospective changes in contribution levels for employees and employers, adjustment in calculation of benefits and any underfunding including changing return of investment percentage to a more current and realistic percentage, efforts to prevent spiking of benefits or the prevention of the unreasonable manipulation of the elements of compensation used in the pension formula for a higher benefit, along with adjustment to pension benefits that clearly are unaffordable and practically cannot be paid are examples of some of the possible pension reforms that could be considered and negotiated.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

7. Further Connecticut case law on ability of state and local government to make necessary and reasonable adjustments to unaffordable pension obligations:

- Collective bargaining agreements are contracts. Connecticut Supreme Court decision recognized contractual obligation should not be construed lightly due to effect on future legislative policies. Noted pension benefits are not gratuities and employees have enforceable rights once they satisfy eligibility criteria under State Employee Retirement Act – presumption against automatic vesting of rights *People v. City of Waterbury*, 266 Conn. 68 (2003); *Fennell v. City of Hartford*, 238 Conn. 509 (1996).

- Application of statutory modification prospectively. Legislation that changes pension benefits that is passed prior to the employee becoming eligible for the pension benefits does not adversely affect the rights of the employee. Prospective legislation does not adversely affect the vested rights that the employee is eligible to receive in the future as opposed to retroactive applications of changes to pension benefits. *Gormely v. State Employees Retirement Com.*, 216 Conn. 523 (1990).
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

- No implied contractual rights to pension benefits. There is no government fostered expectation to pension benefits implied into the statutory provisions by employment manual or other nonstatutory expression of pension policy. There are no implied contract principles to the Retirement Act. For additional retirement of pension benefits to be conferred on public workers, the city must pass legislation in compliance with statutory and charter mandates. Public employees only have property rights/due process rights to pension benefits they have been already eligible to receive not unilateral expectation of benefits. *Fennell v. City of Hartford*, 238 Conn. 809 (1996); *Barde v. Board of Trustees*, 207 Conn. 59 (1988).
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

8. Is loss sharing or risk sharing a possible adjustment to public pension policy that may prevent any future pension funding crisis:

   - Who is responsible for economic downturn and investment losses? There have been 11 economic downturns since 1949. The last two in 2001 and 2008 with market losses or investment of 25-50% of value in major indexes. Governments have raised the issue that if they contribute the actuarially determined annual payment, ARC or ADEC, why should they also fund 100% of the losses on investments. The nature of a defined benefit pension program is that the retiree will receive a fixed determined amount as an annual pension and that amount would not float or be subject to change base on poor investment returns or losses. As noted above in the Boston College Report in 2000, many state and local plans were well funded some at 90-110%, only to experience significant losses during the 2001 and 2008 downturn with the result of a significantly lower funding ratio.
III. The Rights of Public Employees to Pension Benefits Protection and the Ability of Government Employers to Adjust Unsustainable Pension Benefits under Connecticut Statutes and Case Law

- Should there be risk sharing if Connecticut and its local governments annually pay their ARC? The state has for the last ten year period paid the ARC or ADEC as actuarially required to meet pension obligations. These actual investment losses or failure to meet stated returns on investment pension benefit funding should not be the sole burden of the employer if the ARC / ADEC is being paid. Part of the issue of unsustainable and unaffordable pension benefits is the additional payments required to compensate for investment loss or failure to achieve investment goals. The State of Wisconsin, the Wisconsin Retirement System and New Brunswick Public Service Pension Plan have created shared risk plans which have reduced pension funding volatility and uncertainty. Wisconsin's state employment plan is virtually 100% funded using the risk sharing approach. In its simplistic form, a shared risk plan includes a sharing by employer and employees of investment losses by reduced benefits or increased contributions by employer and employees or if the employee fails or decides not to contribute to make-up for losses, there is an appropriate adjustment in pension benefits. There are various formulas for risk sharing but the net effect is clear from the name: not all the cost of investment losses are on the employer.
A. Involuntary modifications of public pensions outside of Chapter 9 bankruptcy is difficult. Outside of a Bankruptcy Court Order, non-consensual changes of pension obligations (unilateral reductions) raise the question of whether they are practically and politically likely:

1. Most state court judges are elected by those affected, either directly or indirectly.
2. This is a local rather than federal matter.
3. Most pension plans are subject to state constitutional or statutory provisions that may raise legal issues as to any adverse change of pension benefits.
4. Pension benefit reduction is obviously unpopular and causes "morale" issues.
IV. Municipal Insolvency and Chapter 9 Impairment of Pension Obligations

5. If the state or local government fails financially, the pension system is sure to follow. But "Necessity knows no laws." Change may be mandated by the reality of the situation – if the state or local government fails financially then it has less funds to keep public employees hired and to pay for pensions. Thus, the pension system will fail, pensioners will receive less, the purpose of the pension will be frustrated and less is truly more, especially if less is assured. Timely modification may save the state or local government and the pension system.

6. Pension adjustment mandated by financial distress. There is precedent to "discharge" pension obligations where the governmental body's survival mandates such action so that essential government services can continue to be provided. See Faitoute Iron & Steel Co. v. City of Ashbury Park, 316 U.S. 511-513 and U.S. Trust v. New Jersey, 431 U.S. 1, 25-28.
Survival of the state or local government is key to long-term survival of pensions. The inability of a state or municipality to fund essential governmental services at an acceptable level can be fatal to pension benefits survival à la Detroit:

1. **Pay what is sustainable and affordable.** What is needed is a mechanism that provides an independent and neutral determination of what is affordable and sustainable so the debate of unwillingness or inability can be transcended to what can be paid and what cannot with appropriate mandated increased funding or adjustment to what can be afforded as pension benefits without eroding infrastructure and essential governmental services at an acceptable level.
IV. Municipal Insolvency and Chapter 9 Impairment of Pension Obligations

2. Bankruptcy may lead to more drastic reductions. Bankruptcy is not only rare but is accompanied by a stigma that affects all creditor relations of the government and has far reaching negative consequences. An intermediate step that provides the benefits of a neutral, independent determination of fact issues and a mechanism for funding the affordable benefit is not only desired but necessary. Otherwise, the ultimate harsh result will be far worse to all.
3. **Not every municipality can file for Chapter 9.** Municipalities of a state can only file for Chapter 9 if they are specifically authorized by the state. Only 12 states allow their municipalities to file for Chapter 9 bankruptcy if they so choose without other conditions or requirements. Another 12 states allow their municipalities to file Chapter 9 conditioned on further review, consent or administrative process by a state official or agency. Three states allow a limited authorization for specific types of municipalities. Two states generally prohibit filing a Chapter 9. The remaining states are unclear or do not have specific authorization. Connecticut allows its municipalities to file for Chapter 9 municipal bankruptcy with the expressed written consent of the governor. If the governor consents, he or she must submit a report to the treasurer and general assembly committee on matters relating to finance, revenue and bonding setting forth the reason for the consent.
IV. Municipal Insolvency and Chapter 9 Impairment of Pension Obligations

4. **Difference between Chapter 9 and Chapter 11.** Unlike a Corporate Chapter 11 proceeding only a municipality (if authorized by its State) can file for Chapter 9 (creditors have no right to initiate a Chapter 9). There is a low threshold for rejecting of labor contracts in a Chapter 9 ("unduly burdensome in proposing a plan") (unlike Section 1113 of the Bankruptcy Code for Corporations-multi-step procedure of disclosure, a proposal and negotiations first). There are no priorities for unpaid wages, benefits or accrued vacation or retirement benefits (Chapter 11 provides a priority over unsecured creditors of up to $12,850 per employee for prepetition wages, benefits accrued vacations and healthcare benefits).
C. Recent Chapter 9 court decisions are unanimous on ability of a municipality in Chapter 9 to modify pension obligations:

Vallejo — Exit ed Chapter 9 in 2011 without tackling pension costs. The city's annual contribution to CalPERs more than $14 million in 2013. Drastic cut in number of public safety employees (almost cut in half). Projected budget deficit for 2015 was $9 million. Could have reduced pension obligations but Vallejo purportedly decided CalPERs penalty for not paying the original pension benefit and for withdrawing from CalPERs was too drastic to justify attempted adjustment.
IV. Municipal Insolvency and Chapter 9 Impairment of Pension Obligations

Stockton – Proposed plan leaves pensions untouched and proposes to continue making required payments to CalPERs. Previously, in 2013, the bankruptcy court judge had suggested Stockton would have difficulty confirming a plan without confronting pension obligations and suggested in dicta that pensions were contractual obligations that could be impaired in a Chapter 9.

On October 1, 2014, the bankruptcy court ruled that the obligations owed to CalPERs were not secured by a statutory lien (as claimed by CalPERs) but rather were an unsecured claim that can be adjusted just like other executory contract claims. (Transcript of Proceedings, October 1, 2014, *In re City of Stockton*, No. 12-32118-C-9 (Bankr. E.D. Ca.).) In addition, there was a February 2015 Bankruptcy Court ruling in Stockton that obligations to CalPERs could be impaired even though the final confirmed plan of adjustment did not so provide. Time will tell the wisdom of the Plan.
IV. Municipal Insolvency and Chapter 9
Impairment of Pension Obligations

San Bernardino – In holding that San Bernardino was eligible to be a debtor under Chapter 9 and rejecting the objection of CalPERs to the filing, the court noted: "The city cannot pay its obligations with money it does not have…. Impairment of contracts seems inevitable…." *In re City of San Bernardino California*, 499 BR 776 (Bankr. C.D. Ca. 2013). This resulted in significant reduction in funding of health care benefits going forward while continuing to pay the pension contribution payment required by CalPERs.
IV. Municipal Insolvency and Chapter 9 Impairment of Pension Obligations

**Detroit**  – In rejecting a constitutional challenge to Chapter 9, the court held that pension benefits can be adjusted in Chapter 9 like any other debt obligation regardless of any state constitutional provisions. Further, while pension benefits can be cut, the plan must be fair and equitable. *In re City of Detroit*, 504 B.R. 191 (Bankr. E.D. Mich. 2013). This decision was made part of the Plan of Debt Adjustment and the appeal was resolved by settlement contained in the Plan.
IV. Municipal Insolvency and Chapter 9 Impairment of Pension Obligations

D. But what do state and local governments do if they cannot file Chapter 9?

1. Absent the use of recourse to Chapter 9, the ability of state courts to address underfunding is uncertain and probably unsatisfactory. Pension plans and provisions for employee benefits should be written to permit modification, especially in the case of dire necessity or hardship to the governmental body. Absent that provision permitting modification, there may be difficulty in obtaining court relief except for impairment permitted for a Higher Public Purpose. Further, state constitutional provisions may prohibit any reduction to the extent of earned benefits.

2. See U.S. Supreme Court precedent in U.S. Trust and Asbury Park cases to permit adjustment of pension obligations for a Higher Public Purpose – the survival of the government.
V. The Benefits of Economic Development and Stimulus from Needed Infrastructure Improvements to Deal with Unfunded Pension Obligations

A. We cannot avoid economic cycles but history of financial stability points the way: In the U.S.A., financial challenges and difficulties in balancing a government budget are not so much caused by the desire to spend more than tax revenues currently generate but rather by economic cycles such as panics, recessions and depressions. The cycles are exacerbated by unfunded pension obligations that are not sustainable and affordable as well as the adverse effects of failing to fund essential services and needed infrastructure at an acceptable level. The healthy economy of a state or local government goes hand in hand with full funding of essential services and needed infrastructure improvements and making sure all costs, including labor and pension obligations, are sustainable and affordable. But will the adverse affects of digital, shared economy and artificial intelligence revolution prevent the needed funding of essential services and infrastructure improvements?
V. The Benefits of Economic Development and Stimulus from Needed Infrastructure Improvements to Deal with Unfunded Pension Obligations

B. Need to address the systemic problems of the past that caused financial distress, namely the tax policy for sufficient revenues and methods of preventing over-leveraging: Other countries that have suffered the need for a debt restructuring due to lack of tax revenue or over-leveraging have generally repeated the process numerous times with band aids rather than a permanent fix because they merely reduced debt without addressing the systemic problems that caused the financial distress. States and local government should always strive for the permanent fix as opposed to the band aid.

C. Balanced budgets require services and infrastructure at the level desired: The state and local governments in the U.S.A. have a long history of financial credibility having learned that quick fixes and failure to maintain governmental services and infrastructure at an acceptable and desired level result in a loss of businesses and individual taxpayers with the accompanying fiscal distress.
V. The Benefits of Economic Development and Stimulus from Needed Infrastructure Improvements to Deal with Unfunded Pension Obligations

D. The state legislatures have assisted in balancing the budget with needed legislation: State legislatures have assisted state and local governments by passing legislation that (i) limits debts and taxes, (ii) provides financial oversight and assistance to those who need it, (iii) assures and requires funding of needed services and infrastructure at the level desired, (iv) respects the principles of government financing and uses statutory liens and special revenues to reduce the cost of borrowing and reinvests in the state and local governments and (v) encourages reinvestment in the state and local governments and creation of new, good jobs and business development.
V. The Benefits of Economic Development and Stimulus from Needed Infrastructure Improvements to Deal with Unfunded Pension Obligations

E. The need to reinvest in state and local governments as party of an acceptable tax pension funding policy:

1. The $3.6 trillion price tag and cost of delay. The American Society of Civil Engineers ("ASCE"), in its 2013 Report, estimates the cost to maintain infrastructure at a passable level will be $3.6 trillion by 2020 or about 4 times the annual tax revenues for all state and local governments. In 2009, ASCE's number for the next 5 years was $2.2 trillion. Inattention has caused the number to increase by $1.4 trillion in 5 years. ASCE's 2017 Report stated the cumulative infrastructure funding needs based on current trends extended to 2025 is $4.59 trillion to have passable infrastructure. Estimated funding for this infrastructure has a gap of over $2 trillion. ASCE discovered in its 2016 economic study "Failure to Act Closing the Infrastructure Investment Gap for America's Economic Future" that the failure to do necessary infrastructure improvements in the U.S.A. will cost the county $3.9 trillion in losses suffered to the GDP by 2025, $7 trillion in lost business sales by 2025 and $2.5 million in lost American jobs in 2025.
V. The Benefits of Economic Development and Stimulus from Needed Infrastructure Improvements to Deal with Unfunded Pension Obligations

2. In its 2018 Infrastructure Report Card, (https://www.infrastructurereportcard.org/state_item/Connecticut) (accessed Jan. 6, 2019)) the American Society of Civil Engineers gave Connecticut an overall grade of C- but warned:

- "Connecticut has high quality drinking water and generally well-maintained water system but these systems are aging and in need of repair and rehabilitation estimated at $4 billion through 2034." (p. 15)
- Connecticut has over 20,000 miles of public roadways … However, more than half of the network is more than 55 years old and a majority of the roads are either in poor or fair condition. The continuation of poorly maintained roads and congestion costs Connecticut users approximately $2.4 billion annually. It is anticipated that approximately $30 billion will be needed to provide roadway facilities that would meet expectation of roadway users within 30 years." (p. 29)
- "Most of Connecticut is served by sanitary sewer systems; however, Connecticut has a was variety of wastewater infrastructure. This infrastructure is aging and need major repairs and rehabilitation. These improvements will require a $4.6 billion investment [to] eliminate sanitary sewer freeflows." (p. 37)
V. The Benefits of Economic Development and Stimulus from Needed Infrastructure Improvements to Deal with Unfunded Pension Obligations

3. Historically state and local government increased reinvestment after economic downturn. Continued borrowing is required to fund needed infrastructure and stimulate the economy as demonstrated by increased borrowing after each economic downturn since 1949, except the last one (2008).
V. The Benefits of Economic Development and Stimulus from Needed Infrastructure Improvements to Deal with Unfunded Pension Obligations

- American Society of Civil Engineers estimates that between 2016-2025 about $4.5 trillion of infrastructure improvements must be made to keep U.S. infrastructure acceptable.
- For every dollar of hard cost of infrastructure improvement, $3.21 of economic activity is generated over the course of 20 years.
- At least $2 trillion of the $4.5 trillion needs future financing. There is currently no estimated funding for it.
- For every new job created due to infrastructure improvements or economic development, there are at least 2 to 5 jobs produced indirectly in supplier industries and induced in local servicing industries.
4. **Economic growth and job multiplier.** Reinvestment in needed infrastructure improvements creates increased GDP. As studies have shown, $1.00 of hard infrastructure costs adds $3.20 over 20 years to GDP growth. Further reinvestment in infrastructure translates into year to year growth of the number of employed workers and GDP growth given the economic stimulus and job multiplier. (Every new job creates service jobs that increase productivity indirectly. This can range from two or three to four or more new jobs depending upon the industry it is created in.) Examples of economic development approaches are set forth in next section on foreign trade zones and industrial parks. The stimulation of economic growth through programs that attract new business to move into financially-challenged states and municipalities and create new jobs increase the tax revenues that help resolve the financial distress and lead to financial recovery of the municipality or state.
VI. Amendment to the Connecticut Constitution May Not Be Necessary or the Politically Most Likely Approach to the Problem of Resolving Public Pensions Problem

A. There are few precedents available from states with constitutional provisions protecting pensions to guide any proposed constitutional amendment: See e.g., Arizona.

B. Model Guidelines for a constitutional amendment or legislative public pension funding policy where state constitutional and statutory provisions and court rulings appear to prohibit or impair needed pension reform:

MODEL GUIDELINES FOR A CONSTITUTIONAL AMENDMENT OR LEGISLATIVE FUNDING POLICY TO PREVENT A PUBLIC PENSION CRISIS
VI. Amendment to the Connecticut Constitution May Not Be Necessary or the Politically Most Likely Approach to the Problem of Resolving Public Pensions Problem

1. **Balanced budget.** Balanced Operating Budget for Governmental Entity for the fiscal year where all expenses and liabilities that are due and payable do not exceed anticipated revenues of the Governmental Entity ("Balanced Budget").

2. **Pay annually the ADC.** The Governmental Entity shall pay in each and every fiscal year the actuarially determined contribution ("ADC") it is liable for under its pension or retirement system for ("Pension Benefits") for that fiscal year provided the effect of any modification or reduction of Pension Benefits required by these Guidelines or determined by its legislative body are included in such calculations. The state may from time to time enact standards and accepted reasonable assumptions to be used in calculating the ADC.
VI. Amendment to the Connecticut Constitution May Not Be Necessary or the Politically Most Likely Approach to the Problem of Resolving Public Pensions Problem

3. Reasonable and necessary modification permitted. Reasonable modification and reduction of Pension Benefits of the Governmental Entity shall be permitted that are necessary for a higher important public purpose of fully funding and providing for essential governmental services at an acceptable level including needed infrastructure and capital improvements ("Governmental Services") as determined in good faith by the Governmental Entity's legislative body or its equivalent ("Legislative Body"). Again, the state may from time to time enact standards or further guidelines for what is sustainable and affordable and an acceptable level of Governmental Services.

4. Fully funding of Governmental Services at acceptable level. The Governmental Entity's Legislative Body shall in good faith determine the amount of full funding of Governmental Services at the acceptable level required for the welfare of its citizens and the appropriate operation of its government.
VI. Amendment to the Connecticut Constitution May Not Be Necessary or the Politically Most Likely Approach to the Problem of Resolving Public Pensions Problem

5. **Reasonableness of modification of public Pension Benefits in relation to Governmental Entity's ability to fully fund and afford Governmental Services and Pension Benefits.** The Governmental Entity's Legislative Body shall make a good faith determination of the reasonableness of any modification or reduction of Pension Benefits in relation to the Governmental Entity's ability to fully fund and provide Governmental Services and afford and fund actuarially determined Pension Benefits as well as maintain a Balanced Budget for the current fiscal year and the foreseeable future. The inability to do so requires the reasonable modification or reduction of Pension Benefits to that which is affordable and sustainable in the good faith determination of the Legislative Body consistent with these Model Guidelines.
VI. Amendment to the Connecticut Constitution May Not Be Necessary or the Politically Most Likely Approach to the Problem of Resolving Public Pensions Problem

6. **Priority of public pension modifications** so that to the extent possible any modification will be first made to unearned future benefits and any impairment of vested rights would be subject to a court validation process. Any required modification or reduction of Public Pension Benefits may be for Pension Benefits to be earned prior to or after the effective date of the modification or reduction with the priority that any modification or reduction first be made to the extent reasonable possible to Pension Benefits to be earned in the future. Any modification or reduction of Pension Benefits earned shall be effective only after a court validation proceeding that confirms the need for the modification or reduction of Pension Benefits in accordance with the Model Guidelines and permitted impairment of contractual rights for a Higher Public Purpose. The Government Entity may also seek a court validation of any reduction or modification of Pension Benefits including Pension Benefits to be earned in the future. This court validation process would follow a statutory procedure similar to bond validation proceedings where the court will validate the reduction or modification after a petition by the Governmental Entity; a hearing with notice to affected parties who have an opportunity to appear determining the modifications and reductions are permitted for a Higher Public Purpose pursuant to these Model Guidelines and required actions and legislative findings have been made.
VI. Amendment to the Connecticut Constitution May Not Be Necessary or the Politically Most Likely Approach to the Problem of Resolving Public Pensions Problem

7. **Public Pension Benefits should be affordable and sustainable by the Governmental Entity.** The Legislative Body in any increase in public Pension Benefits to be granted by a Governmental Entity should determine consistent with the Model Guideline that any increase in benefits is affordable and sustainable by the Governmental Entity and specifically state such benefits are subject to reasonable modification or reduction as necessary to accomplish affordability and sustainability as determined by the exercise of the good faith judgment of the Legislative Body.
VI. Amendment to the Connecticut Constitution May Not Be Necessary or the Politically Most Likely Approach to the Problem of Resolving Public Pensions Problem

8. **Additional legislative findings for any modification of Pension Benefits.** These legislative findings, in addition to those legislative findings and determination as noted above, would generally consist of:

   (A) **Existence of governmental emergency.** A governmental emergency exists or will occur in the foreseeable future that will adversely affect the health, safety and welfare of its citizens and the Governmental Entity's ability to fully fund and provide Governmental Services. Any further increase in taxes and any further reduction in expenditures are in the good faith judgement of the Legislative Body unreasonable and contrary to the interest of citizens and tax payers as well as contrary to financially responsible government ("Governmental Emergency").
VI. Amendment to the Connecticut Constitution May Not Be Necessary or the Politically Most Likely Approach to the Problem of Resolving Public Pensions Problem

(B) Modifications are mandated for the public good. Any modification or reduction of Pension Benefits by the Legislative Body are required in the exercise of its governmental powers in order for the Governmental Entity to be able to fund and provide Governmental Services for other Higher Public Purpose of the health, safety and welfare of its citizens.

(C) Any modification is reasonable in relation to the Governmental Emergency and the extent of any impairment with Pension Benefits paid to the fullest extent possible. A modification or reduction of Pension Benefits is appropriate and reasonable both (1) in relation to the Governmental Emergency and adverse effects set forth in the legislative finding under subparagraph (A) above and (2) the extent of any impairment of Pension Benefits, Pension Benefits should be funded to the fullest extent possible and paid without modification or reduction so long as no Governmental Emergency exists and there is full funding of and provision for Governmental Services as mandated by the enactment of the Model Guidelines.
VI. Amendment to the Connecticut Constitution May Not Be Necessary or the Politically Most Likely Approach to the Problem of Resolving Public Pensions Problem

(D) The harm to pension beneficiaries due to a modification is outweighed by the harm suffered by the Governmental Entity and the citizens. The harm caused by any modification or reduction of Pension Benefits to the beneficiaries pursuant to these Model Guidelines are, in the reasonable judgement of the Legislative Body, the least required under the requirements of these Guidelines and is outweighed by the harm to be suffered by the Governmental Entity and its citizens if such modification and reduction of Pension Benefits required hereunder are not made to address the Governmental Emergency and the lack of funding for providing Governmental Services to its citizens.

(E) The financial creditability of the Governmental Entity preserved. In the reasonable judgment of the Legislative Body, its financial credibility and access to the credit markets are encouraged by any Legislative Body's action hereunder and are not adversely affected or limited by any modification and reduction to such Pension Benefits required hereunder.
VI. Amendment to the Connecticut Constitution May Not Be Necessary or the Politically Most Likely Approach to the Problem of Resolving Public Pensions Problem

9. Any modification or reduction of Pension Benefits pursuant to these principles is not considered an impairment or diminishment. Any modification or reduction of Pension Benefits in compliance with these Model Guidelines hereunder shall not be considered under applicable state constitution, statutes and court rulings to be an impairment or diminishment of the contractual right to Pension Benefits because such Pension Benefits could not realistically be paid by the Governmental Entity due to limited financial resources and the Governmental Entity could not at the same time pay the Pension Benefits without such modification or reduction and fulfill its primary mission of fully funding provisions for Governmental Services along with its financial survival.
VI. Amendment to the Connecticut Constitution May Not Be Necessary or the Politically Most Likely Approach to the Problem of Resolving Public Pensions Problem

C. If no constitutional amendment pursuant to the Model Guidelines is possible then the proposed Model Guidelines can be adopted by Governmental Entities as a statement of public pension policy and enforced through litigation, if necessary.

D. In the long run public education of the extent and seriousness of the crisis must be accomplished.

E. Precise public pension reform under the Model Guidelines and corresponding public pension policy is left to each Governmental Entity to decide for itself given its unique circumstances.
VII. Other Possible Approaches When Pension Reform Efforts Fail or Appear to be Legally Impossible

A. Prepackaged Chapter 9 plan of debt adjustment:

1. For over 25 years, corporations in Chapter 11 have been using a pre-negotiated plan of reorganization done prior to filing for Chapter 11 to expedite the bankruptcy process avoiding the expense, delay and uncertainty of free-fall bankruptcy.

2. Municipalities authorized by their states to file a Chapter 9 could do the same by, prior to filing a Chapter 9, negotiating, soliciting creditor consent to and obtaining favorable creditor class votes for a plan of debt adjustment. After that, a Chapter 9 filing can be accomplished and the time to confirmation of a plan expedited and completed in possibly 3-4 months rather than years.
B. Creation of a special federal bankruptcy court for insolvent state and local government pension funds:

1. Congress has the power under the Bankruptcy Clause of the U.S. Constitution to pass uniform laws on bankruptcy which could include a special court for public pension funds.

2. This special bankruptcy court would be separate from the present federal bankruptcy courts and staffed with judges and other professionals skilled in government finance, budgeting, public pensions, bankruptcy and workout experience. Criteria for filing would be specific ratio of funding or demonstrated inability by the public employer to be able to fully fund. It could be centrally located in Washington, D.C. or a few locations in the U.S.A.

3. Federal legislation would preempt any other laws and give exclusive jurisdiction to the special bankruptcy court.
VII. Other Possible Approaches When Pension Reform Efforts Fail or Appear to be Legally Impossible

4. A plan of adjustment would be proposed by the public employer's governmental body as to what is affordable and sustainable paying as much of the pension obligation as reasonably possible. The plan would be subject to objections of the pension fund, public workers and unions and other interested parties.

5. The public pension bankruptcy court would determine if the plan of adjustment is affordable, sustainable and in the best interest of the pension fund and its beneficiaries (workers or retirees) as well as other parties in interest, citizens and taxpayers of the public employer. The plan of adjustment must assure that essential Governmental Services and needed infrastructure improvement will be timely funded at an acceptable level.

6. This plan process could be done as a prepackaged plan process or through use of mediation during the public pension fund bankruptcy process.
C. Government Oversight, Refinancing and Debt Adjustment Commission ("GORDAC") to assist where public pension reform is otherwise legally or practically impossible:

1. This is a variation of the two approaches above, prepackaged Chapter 9 and Federal Public Pension Fund Bankruptcy Court. State legislation would create a state commission that would help facilitate voluntary agreement but would have the ability as a quasi-judicial body to decide pension issues and bind all parties through a prepackaged Chapter 9.

2. GORDAC would be comprised of at least three commissioners and professional staff experienced in finance, government, accounting, employee benefit and financial restructuring. One commissioner would supervise the mediation and voluntary resolution process, another would be overseeing transparency of information, discovery and relevant financial disclosure and information exchange and another commissioner would be the chief judge to preside over hearing and quasi-judicial determination by the commission.
VII. Other Possible Approaches When Pension Reform Efforts Fail or Appear to be Legally Impossible

3. There would be three phases to GORDAC. The first phase would be to determine the extent of the financial problem (willingness to pay or inability to pay) should taxes and contribution by the employer be raised or should employer contribution and benefits be modified given realistic projection of revenues and expenses of government and availability of funds to pay pension obligations. Voluntary resolution and mediation is encouraged in this phase. If voluntary resolution is not successful the second phase may be requested and, under specified criteria, may be mandatory, namely a quasi-judicial determination of what can be paid and what cannot and the appropriate modification of contributions and benefits.
VII. Other Possible Approaches When Pension Reform Efforts Fail or Appear to be Legally Impossible

4. The second phase, **quasi-judicial determination**, is based on the **recovery plan** of the municipality and its proposal for payments subject to objection by creditors, taxpayers, workers, unions and retirees **recognizing funding for essential services and needed infrastructure improvements at an acceptable level is required** and the recovery plan must be **feasible**, and in the **best interest of creditors**, public workers, taxpayers and pension beneficiaries in that all that can be paid will be paid to creditors and pension beneficiaries without sacrificing the health, safety and welfare of the citizens or the financial survival of the government.

5. The interested parties can be fully informed in a disclosure statement as to the recovery plan and **vote on the plan of recovery as approved by GORDAC** (with possible modifications by GORDAC as it deems appropriate). The plan can then be implemented, if necessary, as a prepackaged plan in Chapter 9.
A. If pension reform efforts under current state law have failed and state constitutional and statutory provisions are obstacles to any needed pension reform efforts, the answer should not and cannot be that the government reduces funding for essential Governmental Services, services decline to unacceptable levels, the government melts financially and corporate and individual taxpayers leave.

B. If public pension funding issues are an unwillingness to pay from a government that has the ability to pay, then the government must step-up and fund the underfunded pension obligation.
VIII. Conclusion

C. If the government has the inability, financially, to pay the underfunded public pension obligations, and it attempts a voluntary or negotiated needed pension reform that has failed or appears impossible due to state Constitutional Pension Protection Clauses or statute and court rulings, then, specifically the Prepackaged Chapter 9 Public Pension Fund Bankruptcy Court, Government Oversight, Refinancing, and Debt Adjustment Commission or Model Guidelines for a constitutional amendment or a legislative public pension funding policy should be considered to address or resolve the public pension issues. (This assumes that taxes have been raised to the fullest extent legally possible or prudent, and the expenses have been reduced to the extent reasonably practical.)
VIII. Conclusion

D. The answer should never be that the needed public pension reforms have failed or appear impossible so the government itself fails and all parties suffer the worst outcome possible.
Appendix

Can raising taxes and pay as you go with normal economic growth of Connecticut solve the pension underfunding problem? (Again, as noted above, the following statistics are not offered for the definitive accuracy which may vary based on assumptions used but for the directional trends and general levels of the matters discussed)

A. Population growth in Connecticut compared to U.S.A. average and other states has not been increasing at a sufficient rate to make a difference:

1. While Connecticut population grew by 3.6% between 1990-2000, its population grew only 5.2% between 2000-2017. While the U.S.A average growth was 13.2% between 1990-2000 and 15.4% between 2000-2017, Connecticut was the 6th slowest population growth of 20 comparable states.
2. Unless there are other factors and/or economic development adding new employers and employees, there appears to be little help from population growth.

3. Compared to other states with significant public pension issues, Connecticut's population growth of 5.2% between 2000-2017 population growth is slower than more popular, larger states such as 16.3% for California, 40.5% for Texas, and 31.2% for Florida.

4. Domestic negative net-migration by Connecticut was third in the nation for population loss with a negative -4.28% between 2010-2017 with New York at -5.25% and Illinois at -5%.
## Appendix


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Source: U.S. Census

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Source: U.S. Census
## Midwest States Percentage of Domestic Out Migration
### 2010 - 2017

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Source: U.S. Census – State Migration Patterns Show Challenges for Rust Belt But Complexities Abound, May 1, 2018 Muninetguide.com. by J. Garceau
## Other Comparable States Percentage of Domestic Out Migration 2010-2017

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Source: U.S. Census – State Migration Patterns Show Challenges for Rust Belt But Complexities Abound, May 2, 2018 Muninetguide.com. by J. Garceau
Appendix

B. Can personal income growth historically be a factor in addressing the public pension underfunding problem?

1. While Connecticut has the largest per capita personal income of the 18 comparison states, it ranks 12th out of the comparable 18 states in the percentage increase between 2000-2017 at 61.9%, less than the U.S.A. average growth of personal income for states of 65%.

2. Among the larger states, Connecticut's 2000-2017 percentage growth of personal income of 61.9% was less than 76% for California, 69.7% for New York, 66.9% for Texas and 71.4% for Pennsylvania.
## Appendix

### Comparison States and U.S. 2017 Personal Income (Gross and Per Capita) % Increase Since 2000

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<tr>
<td>U.S.A.</td>
<td>16,413,500</td>
<td></td>
<td>50,392</td>
<td>3</td>
<td>65.0</td>
<td></td>
</tr>
<tr>
<td>Illinois</td>
<td>676,053</td>
<td>1</td>
<td>52,808</td>
<td>3</td>
<td>59.0</td>
<td>7</td>
</tr>
<tr>
<td>Indiana</td>
<td>294,440</td>
<td>5</td>
<td>44,165</td>
<td>11</td>
<td>57.0</td>
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<tr>
<td>Iowa</td>
<td>144,691</td>
<td>8</td>
<td>45,996</td>
<td>8</td>
<td>67.0</td>
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<tr>
<td>Kansas</td>
<td>138,672</td>
<td>9</td>
<td>47,603</td>
<td>7</td>
<td>35.2</td>
<td>12</td>
</tr>
<tr>
<td>Michigan</td>
<td>450,847</td>
<td>3</td>
<td>45,255</td>
<td>9</td>
<td>49.0</td>
<td>11</td>
</tr>
<tr>
<td>Minnesota</td>
<td>295,798</td>
<td>4</td>
<td>53,043</td>
<td>2</td>
<td>64.4</td>
<td>5</td>
</tr>
<tr>
<td>Missouri</td>
<td>266,920</td>
<td>7</td>
<td>43,641</td>
<td>12</td>
<td>56.0</td>
<td>10</td>
</tr>
<tr>
<td>Nebraska</td>
<td>96,762</td>
<td>10</td>
<td>50,395</td>
<td>4</td>
<td>86.0</td>
<td>2</td>
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<tr>
<td>North Dakota</td>
<td>41,277</td>
<td>12</td>
<td>54,643</td>
<td>1</td>
<td>101.0</td>
<td>1</td>
</tr>
<tr>
<td>Ohio</td>
<td>531,810</td>
<td>2</td>
<td>45,006</td>
<td>10</td>
<td>57.8</td>
<td>8</td>
</tr>
<tr>
<td>South Dakota</td>
<td>41,987</td>
<td>11</td>
<td>48,251</td>
<td>5</td>
<td>80.0</td>
<td>3</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>227,300</td>
<td>6</td>
<td>47,850</td>
<td>6</td>
<td>61.0</td>
<td>6</td>
</tr>
</tbody>
</table>

Source: U.S. Bureau of Labor Statistics
## Comparison State
### 2017 Personal Income (Gross and Per Capita)
#### % Increase Since 2000

<table>
<thead>
<tr>
<th>State</th>
<th>2017 Personal Income $ Billions</th>
<th>2017 Per Capital Income $</th>
<th>% of Increase in Personal Income 2000-2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>2,303.00</td>
<td>58,272</td>
<td>76.0</td>
</tr>
<tr>
<td>Connecticut</td>
<td>251.60</td>
<td>70,121</td>
<td>61.9</td>
</tr>
<tr>
<td>New York</td>
<td>1,210.00</td>
<td>60,991</td>
<td>69.7</td>
</tr>
<tr>
<td>Texas</td>
<td>1,328.00</td>
<td>46,942</td>
<td>66.9</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>666.11</td>
<td>52,096</td>
<td>71.4</td>
</tr>
<tr>
<td>Utah</td>
<td>130.40</td>
<td>42,043</td>
<td>74.1</td>
</tr>
</tbody>
</table>

Source: U.S. Bureau of Labor Statistics
Appendix

C. In Connecticut, state and local debt to GDP is less favorable in comparison to other states in addressing the public pension underfunding problem:

1. For 2018, Connecticut state and local debt as a percentage of GDP is 18.79% which is third highest among the comparable states and greater than the U.S.A. average of 15.57%.

2. Among the largest states only New York with 22.06% and Kansas with 24.53% had a larger state and local debt as a percentage of GDP for 2018 – California was 14.96%, Texas was 17.82%, Pennsylvania was 16.56% and New Jersey was 16.57%.
# State and Local Debt as % of GDP (Estimate for 2018)

<table>
<thead>
<tr>
<th>State</th>
<th>State and Local Debt as % of GDP</th>
<th>Rank by Lowest % of GDP of Debt</th>
</tr>
</thead>
<tbody>
<tr>
<td>All States Combined U.S.A</td>
<td>15.57</td>
<td></td>
</tr>
<tr>
<td>Illinois</td>
<td>18.77</td>
<td>11</td>
</tr>
<tr>
<td>Indiana</td>
<td>14.04</td>
<td>5</td>
</tr>
<tr>
<td>Iowa</td>
<td>9.15</td>
<td>1</td>
</tr>
<tr>
<td>Kansas</td>
<td>24.53</td>
<td>12</td>
</tr>
<tr>
<td>Michigan</td>
<td>15.25</td>
<td>8</td>
</tr>
<tr>
<td>Minnesota</td>
<td>13.28</td>
<td>4</td>
</tr>
<tr>
<td>Missouri</td>
<td>14.19</td>
<td>6</td>
</tr>
<tr>
<td>Nebraska</td>
<td>15.38</td>
<td>9</td>
</tr>
<tr>
<td>North Dakota</td>
<td>15.66</td>
<td>10</td>
</tr>
<tr>
<td>Ohio</td>
<td>12.99</td>
<td>3</td>
</tr>
<tr>
<td>South Dakota</td>
<td>12.09</td>
<td>2</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>14.84</td>
<td>7</td>
</tr>
</tbody>
</table>

Source: U.S.GovernmentSpending.com
## State and Local Debt as % of GDP (Estimate for 2018)

<table>
<thead>
<tr>
<th>State</th>
<th>State and Local Debt as of % of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>14.96</td>
</tr>
<tr>
<td>Connecticut</td>
<td>18.79</td>
</tr>
<tr>
<td>New York</td>
<td>22.06</td>
</tr>
<tr>
<td>Texas</td>
<td>17.82</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>16.56</td>
</tr>
<tr>
<td>Utah</td>
<td>10.08</td>
</tr>
<tr>
<td>New Jersey</td>
<td>16.57</td>
</tr>
</tbody>
</table>

Source: U.S.GovernmentSpending.com
Appendix

D. How does Connecticut pension underfunding match up with other states?

1. In the Pew Report for 2016, Connecticut funding ratio of 41% was the fourth lowest of the states in the U.S.A. with the U.S.A. state average funding ratio of 66%. Illinois was third with 36% and New Jersey and Kentucky were tied with 31%. California had a funding ratio for 2016 of 69%.
### Unfunded Public Pension Liabilities and Funded Ratio – 2016

<table>
<thead>
<tr>
<th>State</th>
<th>Public Net Pension Liability (Assets – Liabilities) (in $ millions)</th>
<th>Rank Highest Liabilities Unfunded</th>
<th>Rank of Highest % Funded</th>
<th>Funded Ratio %</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S.A Total</td>
<td>1,353,892</td>
<td></td>
<td></td>
<td>66</td>
</tr>
<tr>
<td>Illinois</td>
<td>141,169</td>
<td>1</td>
<td>12</td>
<td>36</td>
</tr>
<tr>
<td>Indiana</td>
<td>17,743</td>
<td>5</td>
<td>10</td>
<td>63</td>
</tr>
<tr>
<td>Iowa</td>
<td>6,498</td>
<td>8</td>
<td>4</td>
<td>82</td>
</tr>
<tr>
<td>Kansas</td>
<td>9,218</td>
<td>7</td>
<td>8</td>
<td>65</td>
</tr>
<tr>
<td>Michigan</td>
<td>31,600</td>
<td>4</td>
<td>9</td>
<td>64</td>
</tr>
<tr>
<td>Minnesota</td>
<td>50,909</td>
<td>3</td>
<td>11</td>
<td>53</td>
</tr>
<tr>
<td>Missouri</td>
<td>15,728</td>
<td>6</td>
<td>5</td>
<td>77</td>
</tr>
<tr>
<td>Nebraska</td>
<td>1,516</td>
<td>10</td>
<td>5</td>
<td>77</td>
</tr>
<tr>
<td>North Dakota</td>
<td>2,434</td>
<td>9</td>
<td>7</td>
<td>66</td>
</tr>
<tr>
<td>Ohio</td>
<td>56,541</td>
<td>2</td>
<td>6</td>
<td>72</td>
</tr>
<tr>
<td>South Dakota</td>
<td>338</td>
<td>12</td>
<td>2</td>
<td>97</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>853</td>
<td>11</td>
<td>1</td>
<td>99</td>
</tr>
</tbody>
</table>

## Unfunded Public Pension Liabilities and Funded Ratio 2016

<table>
<thead>
<tr>
<th></th>
<th><strong>NET PUBLIC PENSION LIABILITY</strong> (ASSETS – LIABILITIES) (in $ millions)</th>
<th><strong>FUNDING RATIO</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>$168,016</td>
<td>69%</td>
</tr>
<tr>
<td>Connecticut</td>
<td>$37,452</td>
<td>41%</td>
</tr>
<tr>
<td>New York</td>
<td>$19,011</td>
<td>91%</td>
</tr>
<tr>
<td>Texas</td>
<td>$59,034</td>
<td>73%</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>$68,817</td>
<td>53%</td>
</tr>
<tr>
<td>Utah</td>
<td>$4,651</td>
<td>86%</td>
</tr>
<tr>
<td>New Jersey</td>
<td>$168,243</td>
<td>31%</td>
</tr>
</tbody>
</table>

*Source: Pew Charitable Trust © 2018 The State Pension Funding Gap: 2016*
E. Can raising taxes provide enough funding for Connecticut to solve the public pension underfunding problem without adjustments to public pension benefits?

1. **Per capita tax revenue burden.** Connecticut's per capita tax revenues for the state in 2016 was $4,268, the 6th highest out of 50 states. California was 9th with $3,955 per capita, New York was 7th with $4,120 per capita and Texas was 49th with $1,871 per capita.

2. **Property tax burden.** According to the Tax Foundation, Connecticut property tax, on a per capita basis for 2015, was $2,847 and 3rd highest in the nation. Nationally, California was ranked 21st at $1,451, New York was ranked 4th at $2,697, New Jersey was ranked 1st at $3,074 and Texas was ranked 13th at $1,731.

3. **Income tax.** Connecticut personal income tax maximum rate of 6.99%, and per $100,000 income 6%, New York max income tax rate is 8.82% and California is 13.3%.
4. **Corporate tax rate.** Connecticut corporate income tax rate is 8.25%, nationally, California's corporate tax rate is 8.84%, New York's corporate tax rate is 6.50% and Pennsylvania's corporate tax rate is 9.99%.

5. **State and local sales tax.** The Connecticut state and local sale tax is 6.35%, California at 8.54% (combined state and local average), New York at 8.49% (state and local average combined), Texas at 8.17% (combined state and local average) and Pennsylvania at 6.34% (state and local average combined). Chicago's effective sales tax at 10.25% is the highest in the nation.
## Comparable U.S. State 2016 Gross and Per Capita State Tax Revenue

<table>
<thead>
<tr>
<th>State</th>
<th>Total State Tax Revenues (in Millions)</th>
<th>Per Capital</th>
<th>National Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>$155,231</td>
<td>$3,955</td>
<td>9</td>
</tr>
<tr>
<td>Connecticut</td>
<td>$15,248</td>
<td>$4,268</td>
<td>6</td>
</tr>
<tr>
<td>New York</td>
<td>$81,354</td>
<td>$4,120</td>
<td>7</td>
</tr>
<tr>
<td>Texas</td>
<td>$52,138</td>
<td>$1,871</td>
<td>49</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>$37,395</td>
<td>$2,925</td>
<td>20</td>
</tr>
</tbody>
</table>

Source: Federation of Tax Administrators
## Appendix

### Per Capita Property Tax of State and Local Government Tax Collection 2015 and Rank Nationally

<table>
<thead>
<tr>
<th>State</th>
<th>Per Capita Property Tax Collected</th>
<th>National Rank of Highest Per Capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>$1,451</td>
<td>21</td>
</tr>
<tr>
<td>Connecticut</td>
<td>$2,847</td>
<td>3</td>
</tr>
<tr>
<td>New York</td>
<td>$2,697</td>
<td>4</td>
</tr>
<tr>
<td>Texas</td>
<td>$1,731</td>
<td>13</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>$1,481</td>
<td>20</td>
</tr>
<tr>
<td>Washington</td>
<td>$1,409</td>
<td>23</td>
</tr>
<tr>
<td>South Carolina</td>
<td>$1,130</td>
<td>31</td>
</tr>
<tr>
<td>Oregon</td>
<td>$1,404</td>
<td>24</td>
</tr>
<tr>
<td>Nevada</td>
<td>$959</td>
<td>40</td>
</tr>
<tr>
<td>Idaho</td>
<td>$964</td>
<td>39</td>
</tr>
<tr>
<td>Florida</td>
<td>$1,232</td>
<td>29</td>
</tr>
<tr>
<td>New Jersey</td>
<td>$3,074</td>
<td>1</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>$2,258</td>
<td>8</td>
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</table>

Source: Tax Foundation
## Comparable Other States
### Personal Income Tax Rates

<table>
<thead>
<tr>
<th>State</th>
<th>Max Rate</th>
<th>Rate at $100,000</th>
<th>Graduated Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>13.3%</td>
<td>9.30%</td>
<td>1.0 – 13.3% ($1,000,000+)</td>
</tr>
<tr>
<td>New York</td>
<td>8.82%</td>
<td>6.57%</td>
<td>4.0 – 8.82% ($1,077,550+)</td>
</tr>
<tr>
<td>Texas</td>
<td>None</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Connecticut</td>
<td>6.99%</td>
<td>6.00%</td>
<td>3.0 – 6.99% ($500,020+)</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>3.07%</td>
<td>3.07%</td>
<td>No</td>
</tr>
</tbody>
</table>

Source: Tax Foundation
## Comparable States Corporate and Sale Taxes

<table>
<thead>
<tr>
<th>State</th>
<th>Corporate Income Tax Rate 2018</th>
<th>State Sales Tax Rate</th>
<th>Average Local Sales Tax Rate</th>
<th>Combined Sales Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>8.84%</td>
<td>7.25%</td>
<td>1.29%</td>
<td>8.54%</td>
</tr>
<tr>
<td>New York</td>
<td>6.50%</td>
<td>4.00%</td>
<td>4.49%</td>
<td>8.49%</td>
</tr>
<tr>
<td>Texas</td>
<td>Gross Receipt Tax</td>
<td>6.25%</td>
<td>1.92%</td>
<td>8.17%</td>
</tr>
<tr>
<td>Connecticut</td>
<td>8.25%</td>
<td>6.35%</td>
<td>0.00%</td>
<td>6.35%</td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>9.99%</td>
<td>6.00%</td>
<td>0.34%</td>
<td>6.34%</td>
</tr>
</tbody>
</table>

Source: Tax Foundation Financial Fact 571 and 572, February 2018
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