Public Act 19-117, which implements Connecticut’s state biennial budget for the 2020 and 2021 fiscal years, contains several changes to the Connecticut Teachers’ Retirement System (TRS). This document details these changes and analyzes the projected impact of the changes on the TRS and the State of Connecticut.

Connecticut’s Teachers’ Retirement System (TRS) is a defined benefit plan that disburses a fixed pension benefit to participating teachers upon retirement. Connecticut’s TRS has been in operation since 1939 and is currently funded by the State of Connecticut and contributions from teachers. However, the TRS has accumulated more than $13.1 billion in unfunded liabilities and has one of the lowest funded ratios (57.7 percent) in the United States among similar plans.

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

Changes to the TRS in Public Act 19-117

1. Reamortizes the current Unfunded Actuarial Accrued Liability (UAAL)
   Public Act 19-117 re-amortizes the UAAL over a 30-year period, switching the amortization method from a level percent of payroll amortization to a level dollar amortization (phased in over five years), and amortizes future gains and losses over

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B In 2014, the Government Accounting Standards Board (GASB) changed from requiring an annually required contribution (ARC) to an Actuarially Determined Employer Contribution (ADEC). For the purposes of this memorandum, the terms are interchangeable, but ARC was used when the POBs were issued, while ADEC is used today.

2. Creates a Teachers’ Retirement Fund Bonds Special Capital Reserve Fund (TRF-SCRF) backed by a General Fund surplus and lottery receipts

This fund was designed as a “backstop” to the TRS in recognition of the “adequate provision” language established in the covenants of the POBs issued in 2008. Public Act 19-117 appropriates approximately $381 million to the Treasurer’s Debt Service account to provide initial funding to the TRS-SCRF. If the TRF-SCRF falls below a “minimum capital reserve,” that is, the maximum amount of principal and interest due on the POBs in a given year, receipts from the Connecticut Lottery Corporation will be directed into the TRF-SCRF. Public Act 19-117 also reinforces the rights of bondholders by requiring the State not to reduce payments to the TRF-SCRF until the POBs are fully paid or adequate provision for payment of the POBs has been made and the full ADEC payment, as calculated at the time the POBs were issued, is made to the TRS.

As the new amortization methodology results in an ADEC that is lower than the previous ARC, the second reason for termination would mean the ADEC payment, and associated UAAL, would have increased to previous levels. The TRF-SCRF terminates after the POBs have been fully repaid, if the State deposits sufficient funds to repay the full remaining principal and interest on the POBs in an irrevocable trust, if the ADEC payment under the new actuarial tables increases to a level equal to the ARC payment under the calculation at the time the POBs were issued, or if the Teachers’ Retirement Board (TRB) fails to approve the credited interest percentage and return assumption in accordance with the provisions of Public Act 19-117. The public act also specifies that no money will be credited to the TRF-SCRF until the TRB approves items 3) and 4) below. Once the TRB approves these items, it must request a revised actuarial valuation under the new assumptions, and certify the revised ADEC to the General Assembly.

3. Reduces the TRS assumed rate of return from 8 percent to 6.9 percent, in line with the State Employees Retirement System (SERS)

Public Act 19-117 requires the TRB to reduce the TRS assumed rate of return to 6.9 percent. Assumed rates of return impact the State’s (ADEC). If pension investments do not meet return assumptions, the system will require additional funding to make up for such a deficit. A lower assumed rate of return will require the State to contribute more each year because funds are expected to earn less investment income, but reduce
the likelihood of requiring additional contributions in the future due to investment returns falling below the assumed rate.

4. **Limits credited interest on mandatory contributions to 4 percent annually**\(^{18}\)
   The TRB, which administers the TRS, adopted a six percent credited interest rate on member contributions to the Regular and Supplemental Accounts on June 30, 2018, as was its previous statutory responsibility.\(^{19,20}\) The rate is applied to mandatory member contributions on a yearly basis, and the interest calculated is credited to members who withdraw their contributions from the fund. Public Act 19-117 requires the TRB to limit the credited interest rate to no more than four percent, which decreases the amount of interest paid on member accounts and requires less state resources. For example, if a member contributed $1,000 to the fund in one year and sought to withdraw it from the fund, the State would credit four percent interest on that contribution ($40) rather than six percent ($60).

5. **Increases “Form N” member contribution account to 50 percent of benefit**\(^{21}\)
   Previously, if 25 percent of the aggregate benefit paid to a retiree prior to their death was less than the retiree’s aggregated contributions, the retiree’s beneficiary would be paid the difference between such aggregated benefits paid and member contributions.\(^{22}\) Public Act 19-117 prospectively increases the percentage to 50 percent of the aggregate benefit when computing the proposed lump sum payment for TRS members who retire after July 1, 2019.\(^{23}\) This reduces the expenditure required for this purpose by the State. For example, if a member contributed $100,000 to the fund, and received an aggregate benefit of $50,000, under the previous statute, the member’s beneficiary would be eligible for a lump sum of the difference between 25 percent of benefits and contributions ($100,000 – $50,000 * .25 = $87,500 plus credited interest). Under Public Act 19-117, this member is eligible for a smaller lump sum payment ($100,000 – $50,000 * .50 = $75,000 plus credited interest).

6. **Alters the mechanism for reamortizing the unfunded liability of potential benefit increases**\(^{24}\)
   Previously, any “liberalization” of benefits could not take place unless the General Assembly received an analysis of the unfunded liability created by such change, and the liability must have been amortized using the current amortization method.\(^{25}\) Public Act 19-117 changes the method for amortizing potential liabilities to the level dollar method described earlier, and changes the amortization period from 30 years to a time period “consistent with actuarial recommendations approved by the Retirement Board.”\(^{26}\)

Figure 1 below displays the State of Connecticut’s projected future ADECs for the TRS under three scenarios.\(^{27}\) The first scenario (orange) is the previous baseline (or law prior to Public Act 19-117), if the invested funds for the TRS achieve the previous assumed rate of return of eight percent. The second scenario (blue) is the previous baseline (or law prior to Public Act 19-117) if the invested funds for the TRS achieve the new 6.9 percent assumed rate of return. The third scenario (purple) shows the projected contributions under Public Act 19-117 if a 6.9 percent rate of return is realized.

The changes in Public Act 19-117 are projected to mitigate the anticipated steep increase in the State’s ADEC payments for the TRS until 2032 (the blue line in Figure 1).\(^{28}\) However, such mitigation efforts require increased payments in the years following the steepest projected
increase under the current baseline scenario. The changes are projected to reduce the State's aggregate ADEC for the TRS by $6.6 billion in the years leading up to and including the highest projected ADEC under the current baseline (2032), assuming a 6.9 percent return. After 2032, however, the changes are projected to require $22.2 billion in aggregate additional ADEC funding until 2049, an average of $1.3 billion per year, assuming a 6.9 percent return. In sum, the changes contained in Public Act 19-117 are projected to require a net increase of $15.6 billion in ADEC payments over the projected period (2020 to 2049).

**Figure 1: Teachers' Retirement System (TRS) Projected ADECs ($000s)**

- Orange: Previous Baseline with 8% actual returns for all future years
- Blue: Previous Baseline with 6.9% actual returns for all future years
- Purple: Current Baseline with 6.9% actual returns for all future years
Endnotes

4 Ibid.
7 Ibid.
9 Ibid.
12 Ibid.
14 Conn. Acts 19-117 § 82.
15 Ibid.
16 Conn. Acts 19-117 § 89.
17 Ibid.
18 Ibid.
22 Conn. Gen. Statutes ch. 167, § 10-183g(h).
25 Ibid.
26 Ibid.
28 Ibid.
29 Ibid.
30 Ibid.
31 Ibid.