NEW HAVEN IS IN TROUBLE WITH ITS PENSION AND OPEB LIABILITIES (BUT YOU ALREADY KNEW THAT!)

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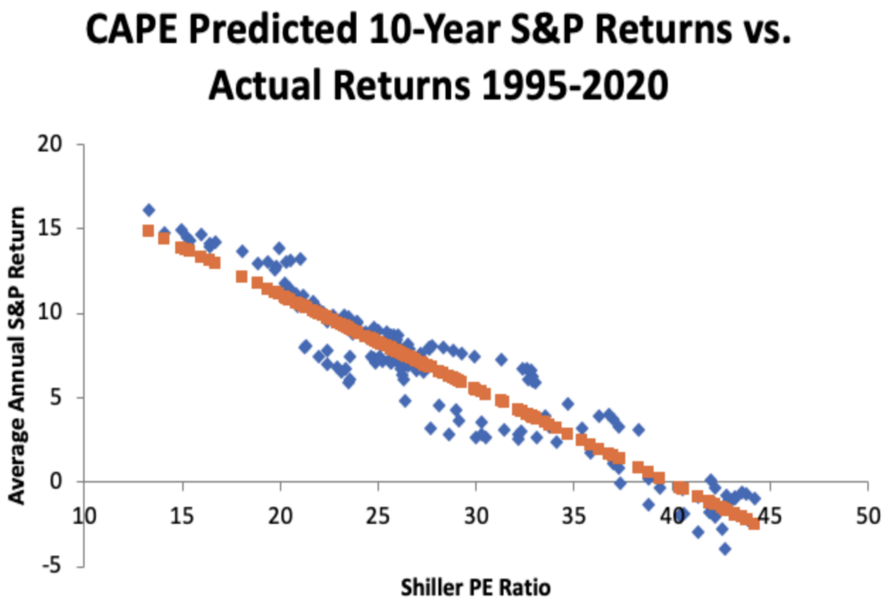
FIRST, LET'S LOOK AT THE SIZE OF THE LIABILITIES

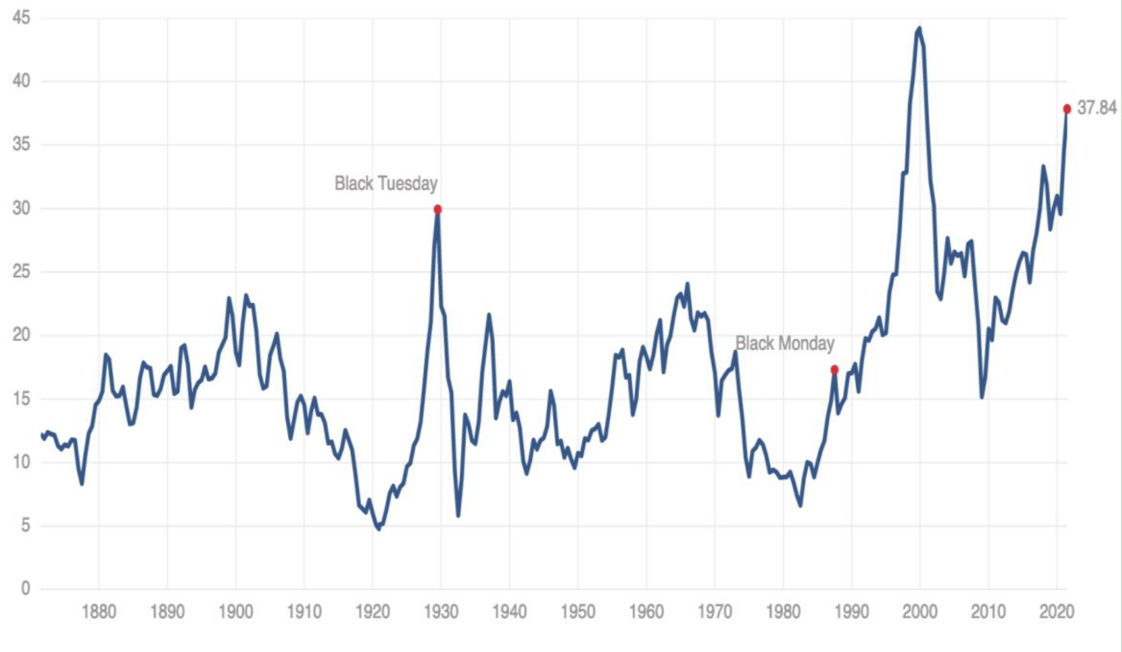
- FY2019 stated unfunded pension liabilities were **$295 MM** and **$506 MM** for City and Police/Fire Plans, respectively.
- Those liabilities grew in FY2020 to **$322 MM** and **$535 MM**, respectively.
- New Haven used a discount rate of **7.75%** in both years to calculate the liabilities.
- At a discount rate of **5.5%**, the FY2020 liabilities are **$426 MM** and **$727 MM**, respectively.
- At a discount rate of **4%**, the FY2020 liabilities are **$508 MM** and **$882 MM**, respectively.
- FY2020 stated OPEB liabilities were **$826 MM**, with no investments and only $5 MM in cash.
- In FY2020, New Haven expensed about **$150 MM** for the two pension plans and the OPEB plan.

WHY USE 5.5% AND 4% AS A RANGE FOR DISCUSSION ON PENSION FUND DISCOUNT RATES?

- If real returns were about 3.75% over the last 20 years and inflation (using U.S. Treasuries) is hovering around 1%, does that point toward **4.75%**?
- Ontario Teachers' Pension Plan (best performing in N.A.) uses **4.65%**
- New Brunswick Public Service Shared Risk Plan uses **4.75%**
- Ray Dalio of Bridgewater Associates (large manager for pension funds) advocates using **4%**
- Pension Fund of the Christian Church (Disciples of Christ) uses **4%**
- Wisconsin Retirement System used **5.4%** in 2018
- Federal Reserve and Bureau of Economic Analysis use **4%**
- Aaron Brown, former AQR Risk Manager, found 50-year pension fund-like portfolios had mean returns of **5.3%**
- FTSE Pension Liability Risk Curve, published by Society of Actuaries, was **2.52%** recently

CONSIDER THE PE10 (or CAPE) RATIOS CREATED BY YALE'S ROBERT SCHILLER

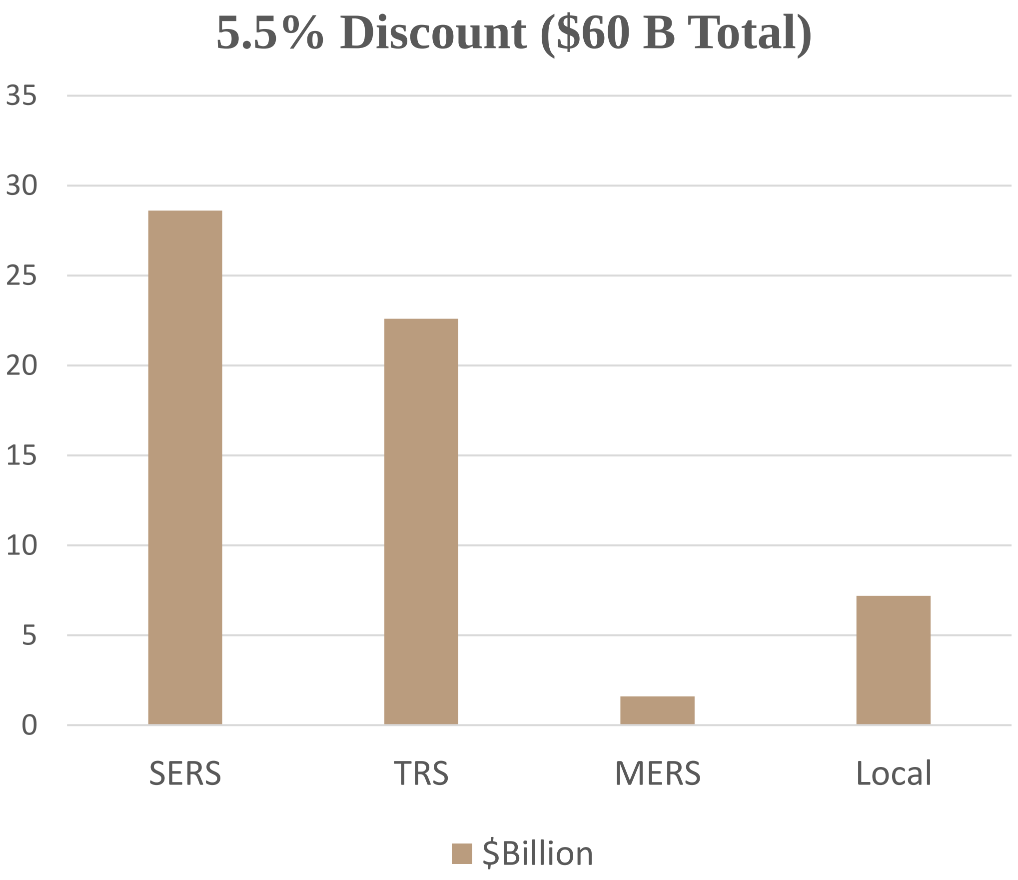


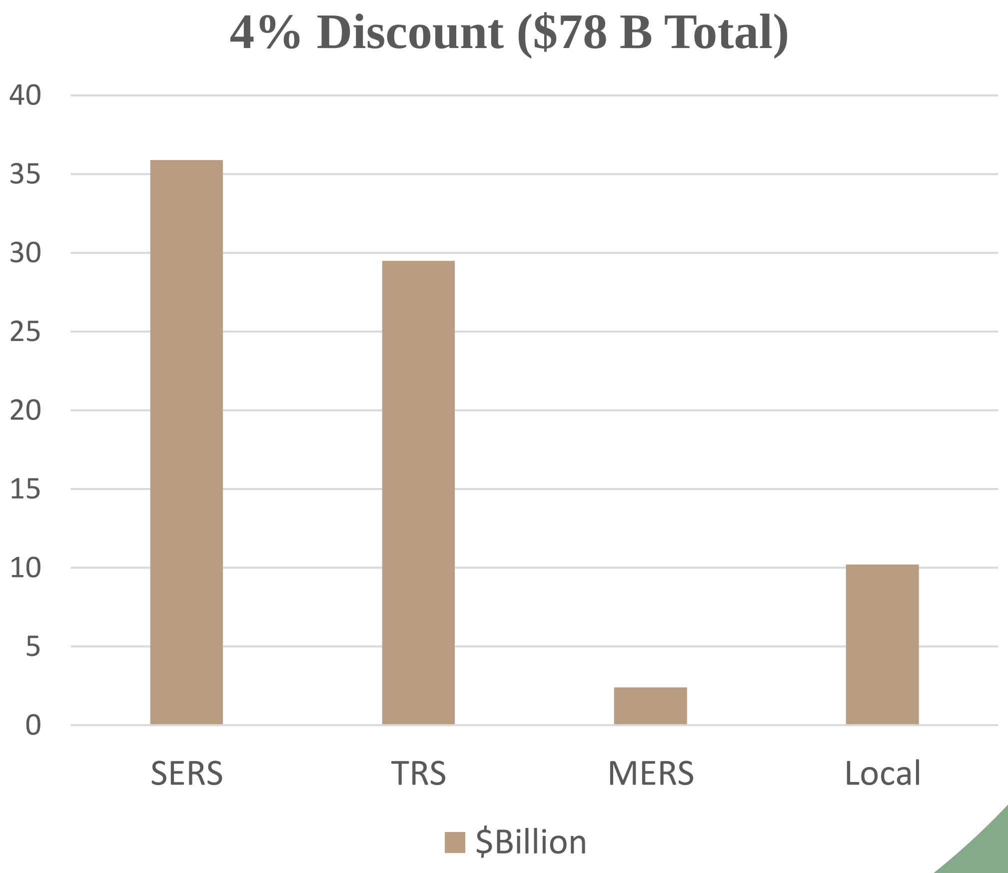


THE PRO BONO PUBLIC PENSIONS PROPOSAL TO CCM—A "GOAL" AND A "BIG TRADE"

- **WARNING—THERE IS SOMETHING HERE FOR EVERYONE TO LOVE AND SOMETHING FOR EVERYONE TO HATE; IT'S MUCH LIKE THE ENVIRONMENT FOR THE 1983 SOCIAL SECURITY REFORMS**
- **THE GOAL—**WE WANT CONNECTICUT PUBLIC EMPLOYEES IMMEDIATELY TO HAVE SECURE, SUSTAINABLE PENSION PLANS COMPARABLE TO THE BEST IN AMERICA (WISCONSIN) AND NORTH AMERICA (NEW BRUNSWICK) AND IMMEDIATELY TO ACHIEVE A 15-YEAR OPEN GROUP FUNDED RATIO IN EXCESS OF 100%
- **THE BIG TRADE—**PUBLIC EMPLOYEES AND RETIREES AGREE TO TRANSITION TO A SHARED RISK MODEL AND GENERATE APPROXIMATELY ONE-THIRD OF THE REQUIRED SAVINGS, AND THE LEGISLATURE IMPOSES A PROGRESSIVE INCOME TAX TO HELP REACH THAT FULL FUNDING. THE INCOME TAX INCREASE WOULD "TRIGGER" ONCE THE SHARED RISK MODEL IS AGREED UPON AND THE SAVINGS ARE ACHIEVED. A CONSTITUTIONAL AMENDMENT SEALS THE DEAL.

WHAT ARE THE SOURCES OF THE UNFUNDED PENSION LIABILITIES IN CONNECTICUT?



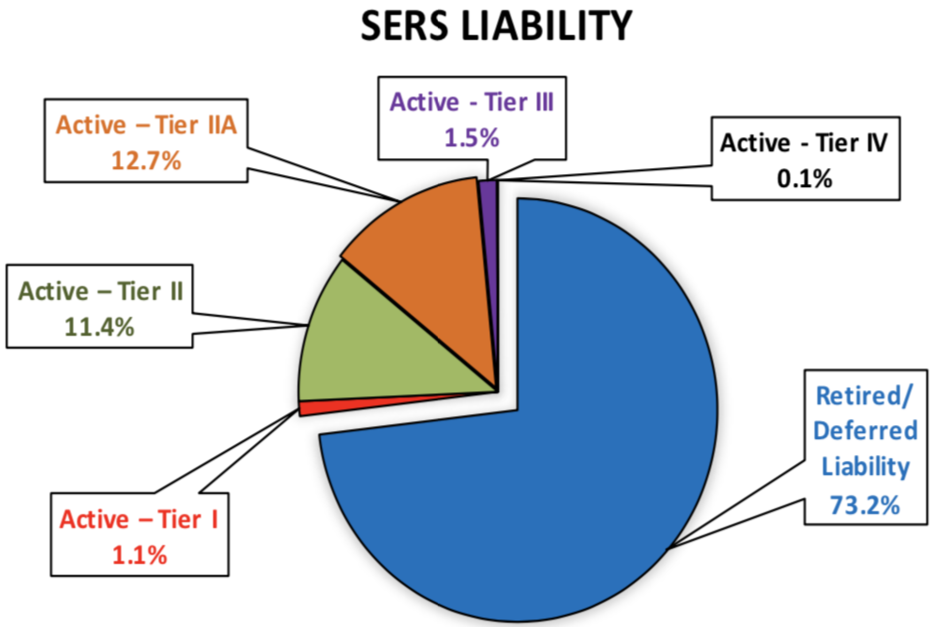


IMMEDIATELY REDUCING THE STATEWIDE UNFUNDED PENSION LIABILITY TO ZERO

- At first glance, this may sound impossible, but it's achieved by trading a previously "guaranteed, but not backed by assets" benefit for a robust shared risk plan that is funded by a constitutionally mandated stream of revenue.
- In this shared risk plan, the "termination value" (the assets) hopefully rises gradually over the next 15 years to at least 100% of the liabilities.
- The 15-year open group funded status of the plan is "termination value" <u>plus</u> the present value of the amortization costs for the unfunded liabilities <u>plus</u> the present value of the "excess" contributions above the normal cost to fund current employees' retirement benefits. The "excess" contributions help provide COLAs.
- Bond ratings should improve immediately, resulting in lower borrowing costs at the State and local level.
- Neither the State nor the municipalities should ever have to issue pension obligation bonds, which create risks of their own.

MAJOR GOAL OF SHARED RISK SYSTEM IS PROTECTING THE BASE BENEFIT, WITH SECONDARY GOALS OF INFLATION PROTECTION AND EARLY RETIREMENT SUBSIDY

- SERS almost perfectly illustrates how the base retirement benefit is <u>not</u> protected.
- **The liability for retirees alone is about twice the size of the plan's assets.**
- Tiers II, III and IV have progressively worse retirement packages and no assets in the fund for them.
- A shared risk plan protects the base benefit for employees <u>and</u> retirees, with secondary objectives of inflation protection and (possibly) a subsidy for early retirements.



REQUIRING THE PAYMENT OF ANNUAL CONTRIBUTIONS THROUGH A CONSTITUTIONAL AMENDMENT

- This is obviously a major benefit for employees and retirees by providing maximum security that the plan(s) will be funded.
- Possible language: **"Sec. 6.1. Beginning with the fiscal year starting July 1, 20__, in order to maintain the target of fully funding the 15-year, open group funded ratios of public employee shared risk pension plans, every sponsor of such plans must remit the actuarially determined employee and employer contributions on not less than a quarterly schedule. Except through further amendment of this constitution, retirement benefits provided under shared risk pension plans may neither be diminished nor enhanced, except in accordance with the provisions of such plans, including funding policies, in force as of the effective date of this amendment. Increases in employee wages and salaries shall not be construed as an enhancement of benefits for purposes of this amendment. Unfunded retirement liabilities may not be created, except those resulting from experience losses, which shall be amortized in accordance with the funding policy of the shared risk pension plan."**
- Evenly protects taxpayers, employees and retirees against manipulation.
- Makes clear the importance of getting the new plan structure right!

CONSOLIDATING THE LOCAL PLANS AND (POSSIBLY) THE LARGE STATE PLANS

- Proposed approach to consolidating the local plans caps contributions at current rate or the new normal cost (whichever is higher).
- Recommendation is to split the new normal cost evenly between employee and employer, but this can be negotiated in the collective bargaining process.
- Recommendation allows underfunded plans with high contribution rates to reduce those gradually over next 15 years; well-funded plans would see little change, recognizing their initial asset contributions to the shared risk plan.
- Should create savings in administrative costs and investment returns. Example: Illinois discovered that its 600+ downstate police and fire plans returned about 2% less than comparable large state municipal plan.
- Proposal rejects idea of moving all local plans immediately to the same contribution rates, a step which would unduly penalize the well-funded local plans.

LENGTHENING WORKING CAREERS

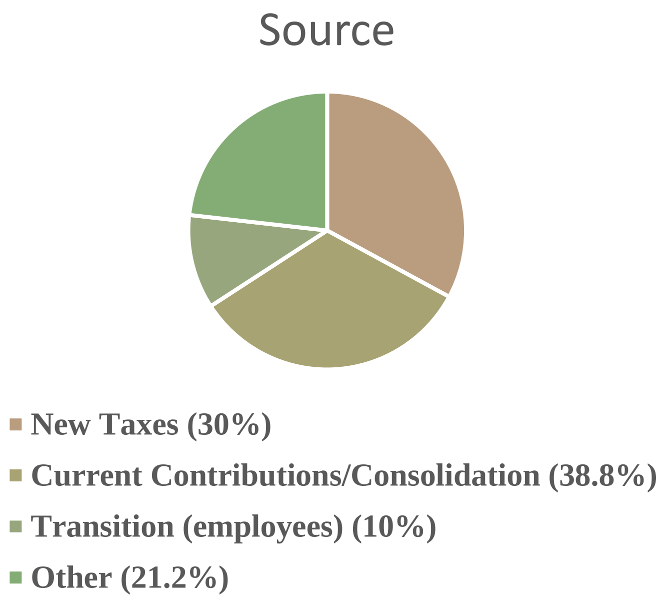
- The proposal recommends linking the normal retirement date for most employees to the normal retirement date for Social Security and to research thoroughly the best available evidence on physical decline and longevity after retirement for public safety employees, including any epidemiological or actuarial experience studies, for purposes of determining whether the normal age of retirement for such workers should be increased to, say, age 60.
- For many employees, this may represent little change under their existing pension plan or under their own personal retirement planning.
- New Brunswick was able to create a gradual transition system into longer working careers so that employees near retirement under the old plan were not suddenly confronted with a situation they had not anticipated. There seems to be no reason why Connecticut could not devise a similar transition plan, although the deeply underfunded status shorten the transition time.

SOME CONSIDERATIONS RELATED TO LENGTHENING WORKING CAREERS

- Employers might be more willing and able to increase wages, which would boost an employee's 35-year average for Social Security purposes.
- Need to maximize end-of-career earnings disappears with a career average plan, opening up possibilities for part-time work near the end of a working career.
- Possible opportunity for lump sum payments, if employee's pension and Social Security seem able to replace more than 75-80% of pre-retirement earnings.
- Cap on earnings for pension purposes might create lump sums for some present employees.
- Possibly, a cap on total pension credits might eliminate employee contributions near the end of one's career, providing an immediate boost in income.
- Finally, some studies have concluded that longer working careers are correlated with greater life expectancies.

PART OF THE "BIG TRADE" REQUIRES MAJOR CONCESSIONS FROM EMPLOYEES AND RETIREES

- **EXAMPLE: With a 5.5% discount rate, amortizing the unfunded liability over 15 years requires annual payments of $5.88 B, or equivalent savings**



The example shown uses 10% reductions in overall liability in the transition to shared risk, and that shows up as an employee contribution. [NB saved 20%.]

- Although the transition savings in liabilities cannot be predicted at this time, some retiree concessions will inevitably be necessary.
- No one pretends that such discussions will be easy. They weren't in NB.
- The proposal stresses the importance of means testing here and offers some possibilities for consideration, although without taking a position on which paths should be taken.

RAISING DEDICATED REVENUE THROUGH A NEW TAX ON HIGH INCOME EARNERS

- The proposal adopts the recommendation of Connecticut Voices for Children that creating new tax brackets, similar to New York's, would raise $1.72 B annually and then dedicating that revenue to the new shared risk pension plans.
- Some may criticize the notion that so much money should be dedicated to a single program, but the proposal also notes there is still room in the current and projected state budgets for other initiatives.
- Ignoring a problem for 80 years does not make it go away.
- The rest of Connecticut's population already strains under high tax burdens, so there seems no reason to make that situation worse.
- The entire State can look forward to real liberation within 15 years.

WHY NOW? THE BETTER QUESTION IS WHY NOT NOW?

- First, Connecticut seems primed for a surplus at the end of June and may pump as much as $1.4 B into SERS and/or TRS.
- Second, the State and most municipalities have been able to contribute their full ADECs (Actuarially Determined Employer Contributions) for the last several years, thereby improving the funding of these plans.
- Third, one unfortunate byproduct of the Covid-19 pandemic is that mortality increased among persons over the age of 65, undoubtedly including many retirees and beneficiaries of Connecticut's public pension plans. One paper has estimated a reduction in life expectancy of 0.87 year for persons over the age of 65. This means that liabilities will decrease.
- Fourth, the stock market has reached record highs. The Boston College Center for Retirement Research estimates that, on average, public plans may improve their funded ratios by about 2%.