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TREASURER NAPPIER PROPOSES FUNDING REFORMS TO STRENGTHEN TEACHERS' RETIREMENT FUND

HARTFORD, CT – State Treasurer Denise L. Nappier today presented a proposal to the Pension Sustainability Commission to improve the health of the Teachers' Retirement Fund ("TRF") and ensure that the State's annual contributions toward teachers' pensions are more affordable and sustainable now, and into the future.

The steps outlined by Treasurer Nappier are:

1. Infuse $3 billion through monetizing lottery revenues and transferring state assets;

2. Move toward a more realistic long-term investment return assumption, from 8 percent to 7.5 percent, in line with capital market expectations;

3. Pay off pension obligation bonds at the earliest opportunity in Fiscal Year 2026, thereby removing restrictions imposed by a covenant linked to the bonds; and

4. Further reduce the long-term investment return assumption from 7.5 percent to 7 percent and modify the amortization schedule for the TRF's unfunded liability.

"From day one of my administration, I've called on governors and legislatures to meaningfully address the State's commitment to responsible funding of pension obligations. Years of kicking the can down the road have deteriorated the health of the fund, and the State now finds itself in the midst of another fiscal storm. The proposal I offer today is designed to put the Teachers' Retirement Fund back on firm fiscal footing, and represents a concrete, tangible plan that would strengthen the long-term sustainability of the TRF while providing relief to the State and avoiding a potential spike," Treasurer Nappier said.

Throughout Treasurer Nappier's 20-year tenure as State Treasurer, in legislative testimony, op-eds and interactions with members of the legislature, she has sounded the alarm on unfunded pension liabilities as one of the most chronic and pressing issues facing the State. She has urged a disciplined approach for funding the State's pension obligations and has objected to efforts to contribute less than actuarially recommended amounts.

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"An essential element for ensuring the soundness and affordability of any actuarially designed plan is consistent funding in an amount determined by the State's actuaries as necessary to reach full funding at the end of the amortization period," Treasurer Nappier said.

Infusion of $3 Billion into Teachers' Retirement Fund Improves the Pension Fund's Health, Saves State $441 Million

In the presentation to the State's Pension Sustainability Commission, Treasurer Nappier said that an infusion of cash and assets in Fiscal Year 2020 would improve the funded status of the TRF, thereby reducing the State's annual Actuarially Determined Employer Contribution (ADEC), without adversely impacting the Fund's cash flow .

Specifically, she recommended that the State issue lottery-backed revenue bonds sufficient to generate cash proceeds of approximately $1.5 billion for deposit into the TRF. Also, it should transfer an additional $1.5 billion of state assets that can then be developed and appreciate in value, she said.

The reduction in the ADEC would more than offset the impact on the General Fund from the debt service cost of issuing the lottery-backed revenue bonds.

Treasurer Nappier has consistently recommended a lower, more realistic assumed investment rate of return for the TRF. She said in her presentation today that a factor contributing to the past underfunding of the TRF has been unrealistic return assumptions. "In other words," she said, "the State ignored a guiding principle that it is more prudent to set an assumed rate of return based on what is achievable, rather than what is desirable."

The cash and asset infusion would allow the Teachers' Retirement Board to lower the fund's assumed rate of return and allow a positive budget impact. In her presentation, she suggested a reduction from 8 percent to 7.5 percent in Fiscal Year 2020.

Infusing $3 billion in Fiscal Year 2020 while reducing the return assumption from 8.0 percent to 7.5 percent will reduce the State ADEC contributions by approximately $941 million dollars for the five years ending Fiscal Year 2025. After deducting debt service, the savings to the General Fund would be $441 million.

Paying off POBs Clears Way for Re-amortization, Savings of $5.1 Billion

Paying off the POBs in Fiscal Year 2026, the first full fiscal year that they can be redeemed, would allow a re-amortization of liabilities without violation of the existing bond covenant.

A key piece of the plan offered by Treasurer Nappier responds to the restrictions imposed by the bond covenant included when the State issued the pension obligation bonds (POBs) in 2008, the proceeds of which were deposited into the TRF. The covenant requires the State to annually pay the full amount of the ADEC for as long as the bonds remain outstanding, and prohibits certain changes to the calculation methods in order to reduce those annual payments.

After Fiscal Year 2025, the State would be in a position to pay off the pension obligation bonds for roughly $1.9 billion, using the estimated State contribution and the POB debt service payment for that year.

At that point, the bond covenant would disappear and the State then could restructure the amortization of the remaining liability to smooth out future annual ADEC payments, thereby avoiding the often-discussed potential spike in State contributions, and, instead reducing the ADEC contribution by approximately $5.1 billion through Fiscal Year 2032.

This option of a one-time diversion of the required contribution would not have a major impact on the TRF's unfunded liability, according to the TRF's actuaries. In addition, it would allow for future debt service savings, for Fiscal Year 2026 of $260 million and overall of more than $2.25 billion by Fiscal Year 2032.

Treasurer Nappier recommended that the assumed rate of return be lowered to 7 percent in Fiscal Year 2026 to better reflect capital market outlooks.

To ensure future funding discipline, Treasurer Nappier also recommended that the legislature adopt provisions to require supermajority votes, with public notice, for any decision by the legislature to pay less than what is deemed actuarially required. Additionally, she said, there should be an adoption of strict limits on spreading out losses due to extraordinary circumstances such as early retirement incentives.

"It is important to remember," Treasurer Nappier said, "that since the redesign of the teachers' retirement plan in 1979 as an actuarially designed plan, the longest period of the State's consistent payment of 100 percent of the actuarially determined employer contribution has been during the existence of the 2008 bond covenant. If the covenant is removed, it is imperative that it be replaced with some statutory restrictions that prevent any backsliding on the State's commitment."

"Through these steps, the Treasury will be able to invest TRF assets in a risk-adjusted manner that will help the State meet its pension benefit obligations and ensure TRF's solvency while moderating the impact to its taxpayers," Treasurer Nappier said.

In her presentation, Treasurer Nappier said the plan she presented today has the best chance of mitigating the projected spike in payments, preserving the State's credit rating, and maintaining the discipline that will be critical to Connecticut's fiscal health going forward.

"It preserves the strict fiscal discipline that the POB bond covenant established," said Treasurer Nappier.

The plan outlined by Treasurer Nappier would adhere to fundamental principles she has maintained during her administration:

- Maintain a disciplined approach to funding the State's long-term obligations and protect the State's creditworthiness by adhering to this discipline;
- Ensure the overall soundness and integrity of the TRF by keeping the State's commitment to its active and retired teachers and minimizing the burden on taxpayers and future generations;

- Base future assumptions of investment returns on what is achievable in the marketplace, defensible in valuing plan assets and liabilities, feasible in setting realistic required annual contributions, and impactful in improving the plan's funded ratio; and
- Preserve and enhance long-term investment performance.

The proposal builds off of a recommendation of the Commission on Fiscal Stability and Economic Growth to use Connecticut Lottery revenues or other assets to strengthen the TRF and the work of the Teachers' Retirement System Viability Commission and the Teachers' Retirement Board.

"It takes a village, as they say, and I want to thank all the affected stakeholders for their input," Treasurer Nappier said. "I also congratulate the General Assembly for not adopting legislation that would have caused a breach in the bond covenant that would have affected the State's standing in the bond market. This plan offers a way forward to ameliorate the impact of the covenant that is legally and fiscally prudent. You don't have to cripple our credit to find a solution."

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