News from:

COMPTROLLER KEVIN LEMBO

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COMPTROLLER LEMBO OFFERS ALTERNATIVE PENSION FUNDING APPROACH

COMMENDS GOVERNOR FOR OPENING CONVERSATION

Comptroller Kevin Lembo this week offered an alternative pension funding proposal for consideration that has the potential to reduce the volatility of future payments to the pension fund and create a more manageable schedule for paying down the unfunded liabilities, while also utilizing actuarial best practices modeled in other states.

Lembo, in a letter to Gov. Dannel P. Malloy this week, commended him for continued focus on fixing the state's broken pension funding system – including what he has already done to pay the full actuarially required contributions since 2012, despite budget challenges, and his latest proposal to reform the state's pension funding methodology.

"It is clear that our state faces unsustainable future pension payments under our current system," Lembo said. "I am in full agreement with your assessment of the problem and the need for action. As you have said, it is time for the state to reform our pension funding methodology in a way that will create more manageable and predictable payments in future years, while responsibly paying our past and present obligations."

Lembo said that Governor Malloy's recent proposal – to separate Tier 1 retirees from the SERS (State Employees' Retirement System) and fund their benefits on a pay-as-you-go basis – has some significant strengths, because it creates more manageable and predictable costs over the long-term and establishes a well-funded system for non-Tier1 employees. However, Lembo said the proposal raises important questions, including:

- What is the impact on federal and other fund fringe benefit recoveries?

- How will credit markets react to splitting Tier 1 members into a pay-as-you-go plan?
- Are there legal constraints on the method of separating the assets between the two groups?
- Will there be an impact on the pre-tax status of Tier 1 member pension contributions?
- What is the long-term cost to the state in foregone investment returns as a result of abandoning a prefunded strategy for Tier 1 employees and retirees?

Citing concerns by the Government Finance Officers Association (GFOA), which urges caution against using open amortization periods, Lembo said, "More traditional adjustments to our pension funding system have the potential to achieve the same goals without creating the uncertainty inherent in the unorthodox approach of moving a portion of retirees to a pay-as-you-go plan or moving to an open amortization schedule."

As an alternative, Lembo recommends:

- Extending the current amortization period;
- Lowering investment return assumptions; and,
- Changing the methodology for amortizing gains and losses based on variations between actual and assumed experience.

Lembo also proposes regular independent comprehensive audits of the plans' actuarial valuations to determine the reasonableness of the actuarial methods and assumptions being used.

"Such regular audits will help right the ship should the state begin to veer off course again," Lembo said, noting that GASB (Governmental Accounting Standards Board) recommends such audits every five to eight years.

"The problems with our current funding systems are clear, but we must be very careful to avoid crafting a solution that creates additional unnecessary long-term costs to the state. A traditional approach that is rooted in actuarial best practices will limit all of the above risks and should be our first option in tackling this problem.

"I propose we engage the plans' actuaries to investigate the potential for a traditional solution to our current funding problems that will meet generally accepted actuarial best practices, retain market confidence and create a predictable payment schedule that establishes a clear path to paying off our past obligations."

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