STATE OF CONNECTICUT

STATE EMPLOYEES RETIREMENT COMMISSION

ACTUARIAL SUBCOMMITTEE SPECIAL MEETING

FEBRUARY 7, 2024 MEETING
HELD VIA ZOOM
CONVENED AT 3:04 p.m.

Present (via Zoom):

Peter Adomeit, Chairman
Michael Bailey, Trustee
Karen Nolen, Trustee
Claude Poulin, Actuarial Trustee
Tim Ryor, Actuarial Trustee
Mark Sciota, Municipal Liaison
John Garrett, Cavanaugh Macdonald
Ed Koebel, Cavanaugh Macdonald
John Herrington, Retirement Services Division Director
Jean Reid, Retirement Services Division
Ben Sedrowski, Retirement Services Division
Megan Piwonski, Retirement Services Division
Ann Marie Rheault, Town of Winchester
Steve Stephanou, Town of Manchester
Cindy Cieslak, Rose Kallor LLP

TRANSCRIPTIONIST: Karin A. Empson

(Proceedings commenced at 3:04 p.m.)

CHAIRMAN ADOMEIT: Okay. This is a special meeting of the State Employees Retirement Commission's Actuarial Subcommittee being held remotely using Zoom technology.

Cindy, do you have the attendance, please?

MS. CIESLAK: Yes. This is Cindy Cieslak. Present today, we have Chairman Peter Adomeit, Municipal Liaison Mark Sciota, Trustee Karen Nolen, Actuarial Trustee Claude Poulin, Actuarial Trustee Tim Ryor. From the Retirement Services Division, we have John Herrington and Ben Sedrowski and Jean Reid. We also have present with us Ann Marie Rheault and Megan Piwonski. And from Cavanaugh Macdonald, we have John Garrett and Ed Koebel. And as I said earlier, I'm Cindy Cieslak, General Counsel for the Retirement Commission.

CHAIRMAN ADOMEIT: Okay. Thank you. We have one item on the agenda, Municipal State Employees Retirement Commission System Experience Study.

MR. GARRETT: Well, thank you, Mr.

Chairman. This is, I guess, volume two of that presentation of the study. So—

CHAIRMAN ADOMEIT: This is John Garrett, since we're on recording.

MR. GARRETT: Yes, sir. Sorry about that.

CHAIRMAN ADOMEIT: That's all right.

MR. GARRETT: So, Cindy, if I can share my screen. I don't know if that's—

MS. CIESLAK: You should be able to. I think I set that up ahead of time.

MR. GARRETT: Okay, perfect. All right. We have the presentation here. Let's see if I can just do the light show. All right. So really, I mean, we went through ninety-five percent of this at the January 17th meeting. We don't want to rehash that unless there's questions about any of those assumptions that are in there. And I apologize again that everything has been kind of compressed here. I was trying to get this done along with some academy work and the MERS valuation for next week.

But really, I just wanted to kind of cover in this meeting, I think, the items we left outstanding from the last, which were a discussion of the COLA that applies to retirees for the period

1/1/2002 to 6/30/25. That assumption is two-and-a-half percent, which is also the minimum of that COLA provision. And we had discussed that we looked at, you know, both historically and stochastically going forward what, you know, a good assumption would be, and really were convinced that 2.65 would be a better assumption for, you know, predicting what that long-term COLA is going to average. But, you know, that does have an additional cost to increase that COLA, and the experience study has already gotten to be fairly expensive.

So why don't I flip to the slide that discusses the COLA? Here, the main points are that when we look at that provision, and again, it's only for those retirees between 1/1/2002 and 6/30/25, when we look at that provision and the way the COLA is determined, it's sixty percent of the CPI up to six percent. And then it's seven-and-a-half percent - I'm sorry, then it's seventy-five percent of the CPI from six to seven-and-a-half.

And so whenever the CPI exceeds 4.167, then we had that issue where the actual COLA is going to be greater than two-and-a-half percent. It has occurred seven times when we look back over the last forty years. And we kind of stopped at the - looked back here kind of in the early eighties because, you know, inflation was really kind of whacky in periods before that, and that was before the Federal Reserve became so proactive in trying to control inflation.

So seven times over the last forty years, but it has occurred twice within the period of this experience study, for 2021 and 2022. And, of course, you know, the CPI measures were pretty high for both those years. Back down now, but those two years, the plan in total suffered about a 102-million-dollar loss due to the COLAs being larger than expected.

So this is the only group that we're concerned that the assumption is under-estimating what the actual long-term rate of the COLAs will be. All the other assumptions, for instance, the people who retired before January 1, 2002, that COLA can raise between three and five percent, but it's not geared on CPI; it's based on the yield kind of over a five-year period of time for the trust. And it's been eleven, I think, twelve years in a row that I know of where that has been set at the minimum of three percent because that return, that yield calculation, doesn't produce an excess above six percent.

So in order for it to be larger than three percent, that yield amount would have to be, you know, over nine because it's the yield line of six percent. So, you know, the three percent minimum, we assume three-and-a-quarter just in those rare cases where the yield is going to be that high averaged over that five-year period of time, but, you know, we haven't seen it yet be in excess of three.

So, you know, and then the other assumption is for people who are retiring 7/1/25; we set those based on kind of the geometric expected average with a little bit of margin. So we're fine with those. This is the only one that is a source of underperformance. It is the largest group of retirees, and it will be for quite some time.

So getting back to the details. Again, when we looked at it both historically and prospectively with stochastic analysis, you know, 2.65 percent looks like, you know, if we were to pick the best assumption for this, it would be 2.65. Considering changing it now, on top of the cost of all the other assumption changes that are being considered in this experience study, it would add an additional roughly half to two-thirds percent of payroll cost to the employers participating in MERS.

And, you know, in my feeling, I mean, with the Fed tightening right now, and inflation rates have already come down well below the 4.167, you know, I don’t know if there would be - you know, we can’t be certain whether or not over the next, you know, five years, for the period of time that this assumption is going to be in place until we look at it in the next experience study in 2027, you know, I’m not sure if we’re really exposed to, you know, a very substantial risk as far as the COLA being much greater than 2.5 percent for the next five years. But, you know, that’s kind of what we left open for consideration.

So I’ll open it up to discussion if anybody has something to add or a different point of view.

MR. POULIN: This is Claude. Excuse me. Well, the 2.5 percent is the minimum. So that it is - over the long run, we know that it will be over 2.5 percent, and your actuarial calculations show that it’s likely to be 2.65 percent over the long run.

Now, my initial reaction was that it’s hard to accept that 2.5 percent would be the assumption when the minimum is 2.5 percent. On the other hand, if we go to 2.65 percent, then it increases the cost by roughly half of one percent for the system, and this maybe seems to be unacceptable.

On the other hand, there is also always a possibility, in order not to be criticized, you know, as using actuarial assumptions that are not really real - this stays like 2.5 percent when the minimum is 2.5 percent - then what if we were to go to 2.55 or 2.6? And my understanding is that it is more or less a linear relationship, so that there would be - at 2.55, there would be an increase of 0.17 percent in the cost of the system, and 0.35.

This is - it would be, in my opinion, more acceptable, and also it would be less than the half one percent that might deem - you know, that might be unacceptable for the minimum standards.

MR. GARRETT: And, Claude, we confirmed that. We actually - you know, when I - when we were talking about this, last meeting, we discussed, you know, phasing in to the 2.65. And, you know, my thinking of phasing it in is the program, you know, that we already take into account, we'll assume in programing that COLAs pay, you know, beginning next year will be 2.55; the year after that, 2.6; and then finally we'd get to the ultimate rate of 2.65. And what I had said at that time was, there's not a lot of difference in that cost between the 2.65 now and kind of deferring the 2.65 for a couple years.

But what the other way of grading in is

kind of what you're discussing, which is we would change the assumption to 2.55 in this upcoming valuation and consider changing to 2.6 at a later valuation, and ultimately get to the 2.65 percent rate, which we would agree is the better estimate of long-term annual rates of COLA for this group.

And we do concur, it's about a 14-million-dollar increase to the UAL versus the 41-million-dollars we have here, and that cost would be, you know, in that ballpark of what you kind of mentioned. We're thinking it's around 15 basis points, up to about 20 basis points; 23 - 22, I think, is what the high end was for one of the systems.

So, you know, that would be, I guess, the good way to go, but, you know, we'd want to, you know, make sure that we are on a path. You know, if that's the process, then 2.55 in the '23 valuation, 2.60 in the '24 valuation, and 2.65 ultimately in the '26 valuation.

MR. HERRINGTON: And this is John Herrington. I don't necessarily want to put our newest members on the spot, but, Steve, Annmarie, and Mark, I think that this is one of the more important decisions that would be made by the Retirement Commission over, you know, the course of a year that would impact participating municipalities. And so the decision that we make here today is going to have an impact on rates going forward.

So I do definitely want to make sure that you all have an opportunity to weigh in or have any questions answered before we kind of settle on what the recommendation would be to the Commission.

MR. STEPHANOU: Thanks, John. I apologize. Steve Stephanou; I'm the Town Manager in Manchester. We - and I join lead. I have hot water boiler issues that I'm dealing with. But just so I know, what are we looking at for - John, the letter that you sent me of what we need to assume for the payroll contributions, so I kind of know what exactly the bottom-line impact is going to be with this decision?

MR. HERRINGTON: Right, right. So this decision point is a part of that process. And so what we're going to decide here are the set of assumptions to use to complete the valuation during next week's meeting, and then part of that valuation and next week's meeting is going to impact the rates. But, yeah, so John Garrett has kind of showed us the comparison here, and hopefully can walk us through.

MR. GARRETT: Yeah, and this is John

Garrett. Yeah, sorry I fumbled around there. But, yeah, it's the last page of that slide deck that we sent that kind of shows the current rates that - these would be the rates set in the '22 valuation, the revised '22 valuation effective for the current fiscal year. The '23 valuation, of course, is going to take into account the new assumptions and whatever experience we've had in the interim year. But right now, based on what we know about the '22 valuation, if we reran that with these new assumptions, these are the rates which we'd be looking at for, you know, what's going to be contained in those letters.

So for general employees without social security, that rate would go up, 15.85 to 16.77; for general employees with social security, 24.68 to 27.00; for police and fire without social security, 21.72 to 23.48; police and fire with social security, 19.75 to 20.95. So, you know, the increases are in the one- to two-percent range across the board. Then further out to the right on that chart, we show, if we change the COLA completely, going from 2.5 percent to 2.6, you know, we see those additional costs ranging from 44 basis points up to 65 basis points.

MR. STEPHANOU: Okay, that's helpful.

MR. RYOR: And, John - this is Tim Ryor.

Just for additional clarity, I think I heard you say the recommended column is not the final 2023 val, but you're not expecting necessarily material differences there. I'm assuming that means it already reflects asset performance.

MR. GARRETT: It does not, because this is just, again, we wanted to compare back to the - you know, to a baseline. The baseline here is the June 30, 2022 revised valuation. So it doesn't - but, you know, the return, the market return for '23 was like 8.2, so a modest gain, but it's going to be more than offset by the losses that are being deferred. So, you know, asset performance is going to push this higher.

MR. RYOR: Okay. I'm just trying to recap the conversation that I don't think everybody here was privy to. So I think the way you summarized it was that those losses are going to offset the gains and maybe any other - there might be gains related to the new assumptions, but typically the non-investment ones pale in comparison to investment ones.

MR. GARRETT: Right.

MR. RYOR: So that is it accurate to say that the rates coming out of the '23 val will be, you know, close and maybe worse than what we're seeing on recommended?

MR. GARRETT: Right, worse being higher, yes.

MR. RYOR: High - yes, yes.

MR. GARRETT: Yeah. I mean, you know, knowing there was an 8.22-percent return and knowing, you know, how much loss that was already kind of in the actuarial value technique, yeah, it's definitely, you know, the actual '23 experience, we already have a headwind in rates going up because of the investment performance.

MR. RYOR: And that was the final context I wanted to provide for everybody is that with the phase-in of the rest of those losses - and I think maybe at some point you were going to do kind of a projection to see where rates are going.

MR. GARRETT: Right.

MR. RYOR: But all other things being equal, if - you know, the COLA assumption aside, if, you know, you nail it with the new assumptions, and experience exactly equals what you assume, that because of the unrecognized investment losses, there's still going to be a mild pick-up in the rates.

MR. GARRETT: I would anticipate that.

MR. RYOR: Okay. I just wanted to give, you know, the—

MR. GARRETT: And kind of what you were talking about, we could have remarkably good non-investment experience, and we're still probably going to have higher rates.

MR. RYOR: Right.

MR. STEPHANOU: So and then it looks like the decision point here on the moving up to 2.65, that basically would result in additional – you know, depending on which group it is, about 50 basis points on the contribution?

MR. GARRETT: Correct.

MR. STEPHANOU: Okay. And then, John, I missed the – I joined as you were talking, and were you considering that maybe we phase in, just based on, you know, inflationary projections, and we're seeing rates coming down where the Fed's at right now?

MR. GARRETT: Right. So I don't think there's very much risk to phasing-in. I actually – you know, I'm kind of indifferent to changing between now and the next experience study just because the environment we're in, I mean, I doubt seriously that we're going to see CPI kind of creep back above that four-and-a-sixth percent range. But, you know, long-term, we're going to, you know, be better off, as soon as we can get to a 2.65-percent assumption for that group.

MR. STEPHANOU: Yeah.

MR. GARRETT: And, yeah, so Claude had mentioned a different – you know, when I was talking last week, I was talking about programically – programically, that word – you know, phasing it in in the funding valuation programs that we use. And that really wouldn't change the liability measure that much. But the phase-in method that Claude was discussing is that we just make an assumption of 2.55 for the '23 valuation, and then in the '24 valuation, we'd make the COLA assumption for this group 2.60. And then in '25 valuation, we'd ultimately get to the 2.65-percent rate, which would be the better long-term assumption.

And, you know, we're done with the phase-in at that point. Those costs would be cut roughly into third each of those, you know, steps that we take toward getting to 2.65, so, you know, in that 15- to 20-basis-point range of increases. Kind of in the '23 valuation, we'd see it. We'd also expect it for the '24 and '25.

MR. STEPHANOU: That sounds good and sound from my standpoint. I'd be curious, Ann Marie (inaudible) Mark.

MR. SCIOTA: Mark Sciota from

Southington, Town Manager. I agree. I was going to mention, I like Claude's idea. It's a lot easier for municipal management if we know that we're going to do it over the next three years. I think that makes sense. So I would definitely support - I support that we should - I don't agree that we stay at 2.5. I think that - it's possible we could do that, but I do think that we need to be more realistic, but I'd like to do it over a three-year period.

So I would agree with that recommendation that Claude gave us.

MR. STEPHANOU: Same here. Mark, you're not going to have to worry about it though.

MR. SCIOTA: Well, I'm still doing this budget, Steve. So I still have to worry about that.

MR. GARRETT: So that's COLA. And so based on that, we'll prepare - you know, we'll prepare the '23 valuation with an assumption of a 2.55-percent COLA for this group. And then there was a couple other items in here which we just wanted to point out.

Tim, we did go back and look right after we had our discussion. We kind of looked at the data for service-connected disabilities for general employees. And to be honest with you, I mean, my impression is it's always been kind of loose, you know, that data. But actually, it hangs together pretty good over the five-year period we're looking at. And clearly, zero is way underestimating how many service-connected disabilities occur for general employees.

So we're recommending that we change that to 50 basis points. I have the impact. It's super, super minor. It actually is - it's actually like a two-million-dollar increase to the present value of benefits, which is, you know (inaudible) two million - you know, that number is like - it's hundreds of millions. So we'll actually see it actually affects the accrued liability by increasing it a little bit, which we sometimes see with these ancillary type of benefits.

So we recommend - and we have - the impact that you have in front of you does include a fifty-percent service-connected disability assumption for general employees. And I think that was - that was all the adjustments that we had made since we last presented all of this.

And for those new members on the board, count your blessings that you did miss the roughly two-hour presentation of these charts and numbers, which I have plowed through quickly to get to the last slide. But - and we're happy to, you know, address any questions anybody might have. But just think of all the time you have on your hands now that you wouldn't have otherwise.

MR. SCIOTA: John, Mark Sciota again. So from now until next Wednesday, what will you be doing to prepare for next Wednesday, to get us the final number?

MR. GARRETT: So there's a few items, items that we're hoping to get onto the agenda for next Wednesday. One, of course, is the valuation for 2023 based on these new assumptions. So, you know, we needed this interim meeting with everything finished, the impacts determined, and so that we can get by and, you know, the Subcommittee's blessing on what's being recommended.

So with that, we'll present next week the 2023 actuarial valuation, which will have the rates established based on '23 experience. Again, I expect it to be slightly higher than what's in this slide deck, and then that's going to be the basis for the letters that go out to each of the towns. And then the other piece is going to be, we also have the valuation for police and fire survivor benefits that we're hoping that that is going to get finalized and presented at next week.

And then the GASB reports for GASB 67, which is going to be the basis for the GASB 68 report, which is not really needed until financial reporting for '24 is being put together. But we typically like to get it done as soon as the valuation is ready.

So, I mean, it's going to be a little bit of day. And I guess also at that meeting, Peter, would be the official recommendation to the full commission on accepting the experience study. We'll make the modifications to what - you know, we'll change and point out that we're using the 2.55 and we're going to grade-in to the 2.6. We'll change that discussion in our report right now, the draft report, as a discussion about using 2.65, but it doesn't really, you know, have a definite path forward.

Now that we know, we'll talk about how we're going to grade into that 2.65 percent COLA rate. And so with that, the report will be ready to be passed on to the full commission.

CHAIRMAN ADOMEIT: So now then, we'll need Claude to make the motion to accept the report; correct, Claude?

MR. POULIN: This is Claude. I move to accept the Actuarial Report. Now, this would be the experience investigations?

MR. GARRETT: Yes, yes, sir. And now there's not a commission meeting tomorrow; right?

CHAIRMAN ADOMEIT: No, it's next—

MR. POULIN: No, it's next week.

MR. RYOR: No, next week.

MR. GARRETT: Yeah, next week, all right.

MR. POULIN: And I believe that we have a meeting in the afternoon of next Wednesday; isn't it?

MR. GARRETT: Right.

MR. POULIN: Yeah.

MR. RYOR: Yeah, this is Tim. That's the meeting we would - we'll get the '23 val that we - that's what we will then approve that will go to the—

CHAIRMAN ADOMEIT: Okay.

MR. RYOR: Because there's nothing - correct me if I'm wrong, there's nothing coming out of this meeting that's going to the full board; correct? This was just so they can proceed with the '23 valuation. So then—

CHAIRMAN ADOMEIT: Got it.

MR. GARRETT: Well, so - and this is John Garrett again. So next Wednesday, what we'll do is we'll have the final experience study report, which could then be - and again, that will include the discussion of how we're grading in this COLA assumption. And that would need to go to the full commission that following day, along with the MERS ’23 valuation and—

MR. RYOR: Perfect.

MR. GARRETT: --whatever else, the police and fire survivor benefit fund, whatever other pieces of work we’re going to be dumping on you next week.

MR. RYOR: This is Tim again. I know we talked about it. I’m just – I know you’ve got a lot on your plate, so hopefully this is in the works. Is it possible to get that display to kind of show the ultimate rates of where things are headed, kind of with the val results, so people, when they’re making a decision on what they’re approving, they see kind of the consequences down the road—

MR. GARRETT: Right.

MR. RYOR: --of when we eventually get to six-five when all the investment losses are phased in, you know, you’re seeing a rate today that will be for the next fiscal year?

MR. GARRETT: Right.

MR. RYOR: But then, you know, four years down the road, you’re expecting it to phase up to some other number, and just so everybody has a sense of what the number is.

MR. GARRETT: Yeah. So a part of our contract now also includes us performing 30-year projections of the fund, open-group 30-year projections. So we do plan – it's going to probably not be at the next week's meeting, but it will be shortly thereafter. We'll share it with everybody in a – you know, we'll kind of show you what it looks like. And then we can discuss it at a future Subcommittee meeting.

But we are – you know, our task of work is to, as soon as we're done with valuations, then depending on the urgency of GASB, we fit into performing those projections as soon as possible. Because, you know, to be honest with you, and I think that's where you're going too, there's no better analysis that an actuary presents to a pension board than long-term open-group projections. I think that's the better indication of where we're going instead of taking a valuation and (inaudible) just kind of deterministically says, hey, we're going to be magically, a-hundred-percent funded in 25 years.

So, yeah, that's definitely on our list of things to do, and it's pretty high up there.

MR. POULIN: This is Claude.

MR. GARRETT: It – I just doubt it's

going to be ready next week, Tim. I'm sorry.

MR. POULIN: The only other question that - this is Claude. On the service-connected disabilities, the change in general employees from zero percent to 15 percent being service-connected, is it expected to eliminate the losses, actuarial losses?

MR. GARRETT: No. You know, this doesn't cost a whole lot of money, Claude, because it's driven by rates of disability that are tiny. You know, if - bear with me here and I'll pull up just kind of a chart that - plus, the new folks can see what they missed last week. This is - can you imagine hearing my voice through all these slides?

Withdrawal, disability, right here. So if you look out to the left, you know, that vertical scale, that's the size of the rates for general employees.

MR. POULIN: Oh, okay.

MR. GARRETT: So point-zero-five percent, point-one percent, so they're really tiny rates that are driving these benefits. So change in that service-connected, even though the benefits are dramatically better, right - you have to have ten years of service to have a non-service-connected disability, you know, there's - well, you know, that's basically the biggest difference, I think. I can't remember what the other stuff is.

But, you know, it's not a huge difference in how the—

MR. POULIN: Yeah. Thank you.

MR. GARRETT: Yeah. And to be honest with you, when we looked back at the data, Claude – this is John again – yeah, I mean, it was pretty clear that in most years, it was forty to fifty percent of disabilities were service-connected. There was one year, I think, in there that was actually 66 percent, well, two out of three. And, you know, again, it's a pretty small number of occurrences, but still, when they do occur, there is, you know, a little bit of a difference in eligibility for the service—

Oh, you know what? I'm sorry. That's the other difference. So service-connected disability has a fifty-percent-final-average-pay minimum, whereas the other is just based on your years of service in the formula benefit.

MR. POULIN: That's right. Thank you.

MR. GARRETT: Yes, sir.

CHAIRMAN ADOMEIT: Okay. John, anything else?

MR. GARRETT: I – yeah, I need a break.

No, I'm - you know, the good thing is, you know, I don't - I know I'm probably not going to be highly utilized in the next MERS experience study report because I'm either not going to be on Earth or certainly not being behind a desk. So this perhaps might be my finale for MERS experience studies.

Ed, who, you know, is as involved as I am in doing this, he's just younger. But he could be at the helm for this one next time.

CHAIRMAN ADOMEIT: Okay. All right. Well, then I guess we're ready to adjourn.

MR. POULIN: I move to adjourn. This is Claude.

MR. BAILEY: Bailey, second.

CHAIRMAN ADOMEIT: Okay. All in favor, say aye or raise your hand. It's unanimous; the ayes have it.

Hey, thank you all very much.

MR. GARRETT: Thank you.

(Adjourned at 3:36 p.m.)

I, Karin A. Empson, do hereby certify that the preceding pages are an accurate transcription of the Connecticut State Employees Retirement Commission, Actuarial Subcommittee Special Meeting held electronically via Zoom, conducted at 3:04 p.m. on February 7, 2024.

Karin A. Empson

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02/25/2024

Date