THE PEW CHARITABLE TRUSTS

2005 Market Street, Suite 2800 215.575.9050 Phone
Philadelphia, PA 19103-7077

901 E Street NW 202.552.2000 Phone
Washington, DC 20004

www.pewtrusts.org

Overview and Analysis of the Pension and Retiree Healthcare Provisions of the Tentative 2017 SEBAC Agreement

The following is an overview and analysis of the pension and retiree healthcare provisions of the tentative agreement reached between the State of Connecticut (State) and the State Employees Bargaining Agent Coalition (SEBAC) on March 23, 2017 and ratified on July 17, 2017.

This analysis, by The Pew Charitable Trusts' public sector retirement systems project, is being provided at the request of policymakers in the state and does not constitute an endorsement of the agreement or address a comprehensive solution to the state's long-term fiscal challenges. Our analysis is based on the provisions documented in the 2017 SEBAC Agreement and the state's analysis over a five-year time horizon, with the understanding that the SEBAC Agreement and certain benefit provisions will be extended to June 30, 2027.

Key Findings

- **Summary of Savings**: According to state officials, expected savings of $4.8 billion over five years are split between wage concessions (51%), adjustments to pension benefits (27%), including increased employee contributions, and changes to active/retiree health care benefits (22%).
    - Wage concessions will also impact pension savings because the projected final average salary for current workers – the basis for pension benefit calculations – is projected to be lower.
    - Note that we have included $270 million in savings associated with lower staffing levels through attrition per the provisions documented in the 2017 SEBAC Agreement
- **Impact of Pension Changes for Current Workers**: Estimated impacts to pension costs appear reasonable based on independent actuarial analysis, using the plan's own assumptions. We estimate that 6% of total savings is the result of increasing employee contributions. The balance – 21% of total savings – is based on reducing the state's actuarial contributions to the State Employee Retirement System (SERS) to reflect lower projected benefit payments for current workers in retirement tied to wage concessions and reduced COLA benefits.
    - Savings from benefit changes is the result of both the reduction in the current SERS liability and unfunded liability, estimated at about $1 billion, as well as a lower cost of new benefits for workers going forward.
    - Note that the impact of the 60% cap on overtime is not included in either the state or Pew's analysis due to data limitations.
- **Projected Cost of the Hybrid Plan for New Workers**: The defined benefit/defined contribution (DB/DC) hybrid plan for all new employees (Tier IV) can be expected to substantially lower cost and risk for taxpayers over time. The state's expected cost is 2.7% of pay, including 1% into the DC accounts, with an estimated cost of only 4.2% if investments only return 5% instead of the plan assumption of 6.9%. In comparison, the current Tier III

benefits have an expected employer cost of 4.5%, increasing to 8.5% if investments only deliver 5% returns.

  - Separately, policymakers may wish to consider adding provisions in the future that incent workers to save more in the defined contribution accounts given the low mandatory savings rate of 2% of pay, including the employer match.

- **Retiree Health Care**: The cost reductions associated with transitioning to Medicare Advantage – which accounts for 95% of the retiree health care savings and more than half of total health care savings over the first two years – is the result of a well-documented procurement process, with pricing for the first two years guaranteed. However, current projections beyond the second year of the agreement do indicate a return to higher rates of health care cost growth. (projected cost levels over five years are currently being reviewed by state officials – existing documentation reflects maximum price levels)
- **Increased fiscal monitoring:** Connecticut is one of only four states, based on our research, which addresses pension funding and benefits as part of collective bargaining. Pew recommend that the legislature consider additional policy measures to supplement existing processes, based on initiatives that other states have recently adopted, to more closely monitor the fiscal health of the state's retirement systems going forward:
  - Commission a 50-state comparative study of retirement benefits and policies, as well as an independent actuarial assessment, to help ensure Connecticut is in line with peer states.
  - Require stress test analysis of all retirement plans as part of regular reporting to determine how the plan would perform during a financial crisis.
  - Establish a policy to fully disclose alternative investment fees in order to increase transparency and control costs.

The following Exhibits are based on Pew's 50 state research and state specific analysis.

<u>List of Exhibits</u>

- SEBAC 2017 Agreement – Projected Budget Savings (FY 2018-2019)
- SEBAC 2017 Agreement – Projected 5 Year Savings (FY 2018-2022)
- Pension Savings Over Five Years: State Projection vs. Independent Assessment
- Comparison of Defined Benefit Contribution Rates for State DB Plans
- Comparison of Defined Benefit Multipliers for State DB Plans
- 50 State Data on DC and Hybrid Plans
- Sensitivity Analysis: Defined Benefit Contribution Rates
- Medicare Advantage Regional Comparison Trends
- Medicare Advantage Savings
- Policy Considerations
- Legality of Collective Bargaining Across 50 States
- Use of Collective Bargaining to Set Benefits Across 50 States
- Stress Testing and Fee Transparency Policy Adoption Trends

For further information, please contact Tim Dawson at tdawson@pewtrusts.org

Prepared by The Pew Charitable Trusts

SEBAC 2017 Agreement - Projected Budget Savings

Savings FY 2018 – FY 2019		
Wage Concessions and Attrition	50%	$.8 billion
Adjustments to Pension Benefits and Contributions	29%	$.4 billion
Changes to Employee and Retiree Health Care	21%	$.3 billion

Source: Based on preliminary public data from 2017 SEBAC Agreement Savings Estimates. Note that wage concessions impact pension savings as it lower the final average salary for all current SERS employees and result in reduced pension benefits. Savings from lower staffing levels due to attrition account for approximately 5% of total savings.

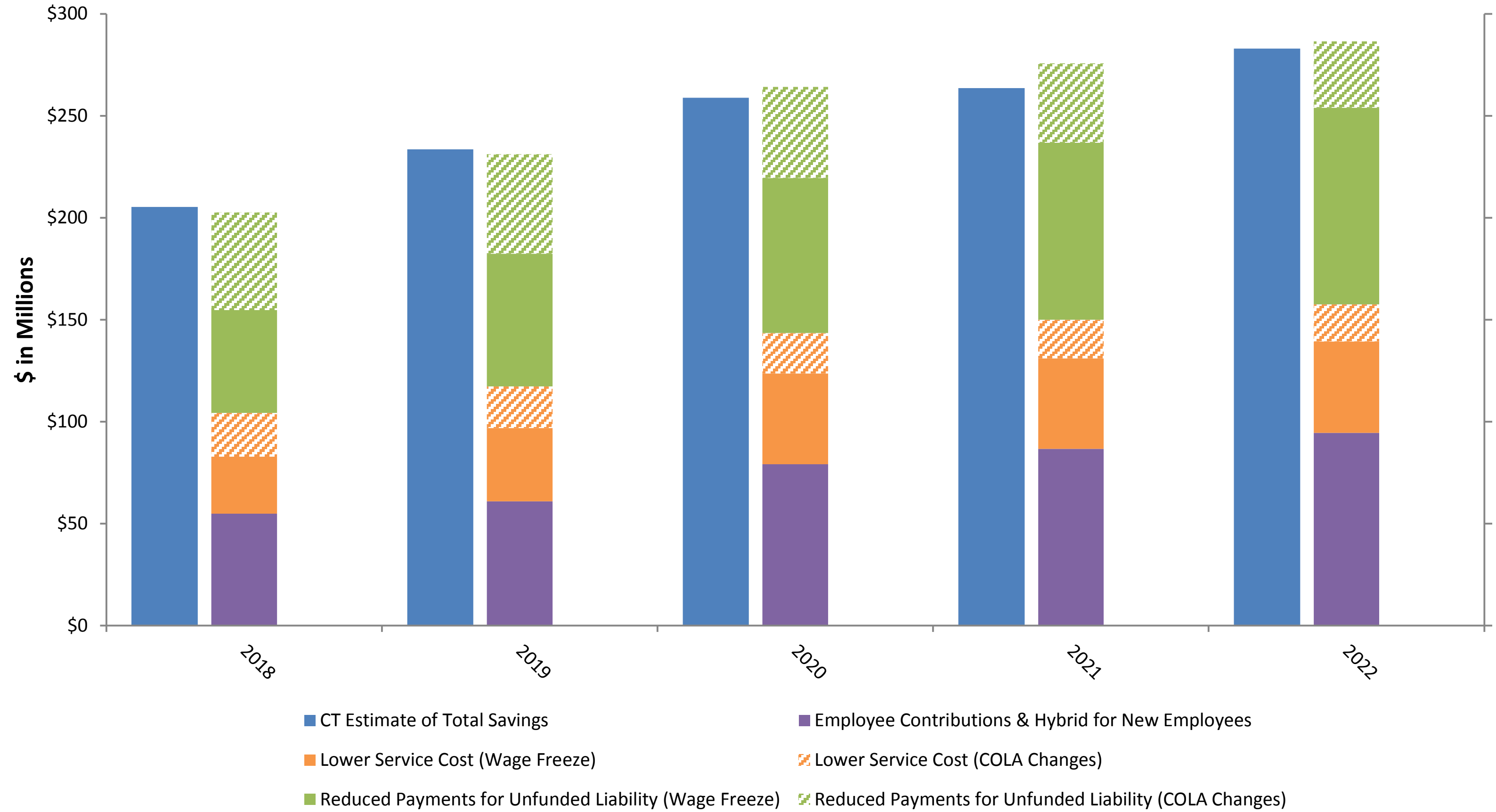
SEBAC 2017 Agreement – Projected 5 Year Savings

Savings FY 2018 – FY 2022		
Wage Concessions and Attrition	51%	$2.5 billion
Adjustments to Pension Benefits and Contributions	27%	$ 1.3 billion
Changes to Employee and Retiree Health Care	22%	$1.0 billion

Source: Based on preliminary public data from 2017 SEBAC Agreement Savings Estimates. Note that wage concessions impact pension savings as it lower the final average salary for all current SERS employees and result in reduced pension benefits. Savings from lower staffing levels due to attrition account for approximately 5% of total savings.

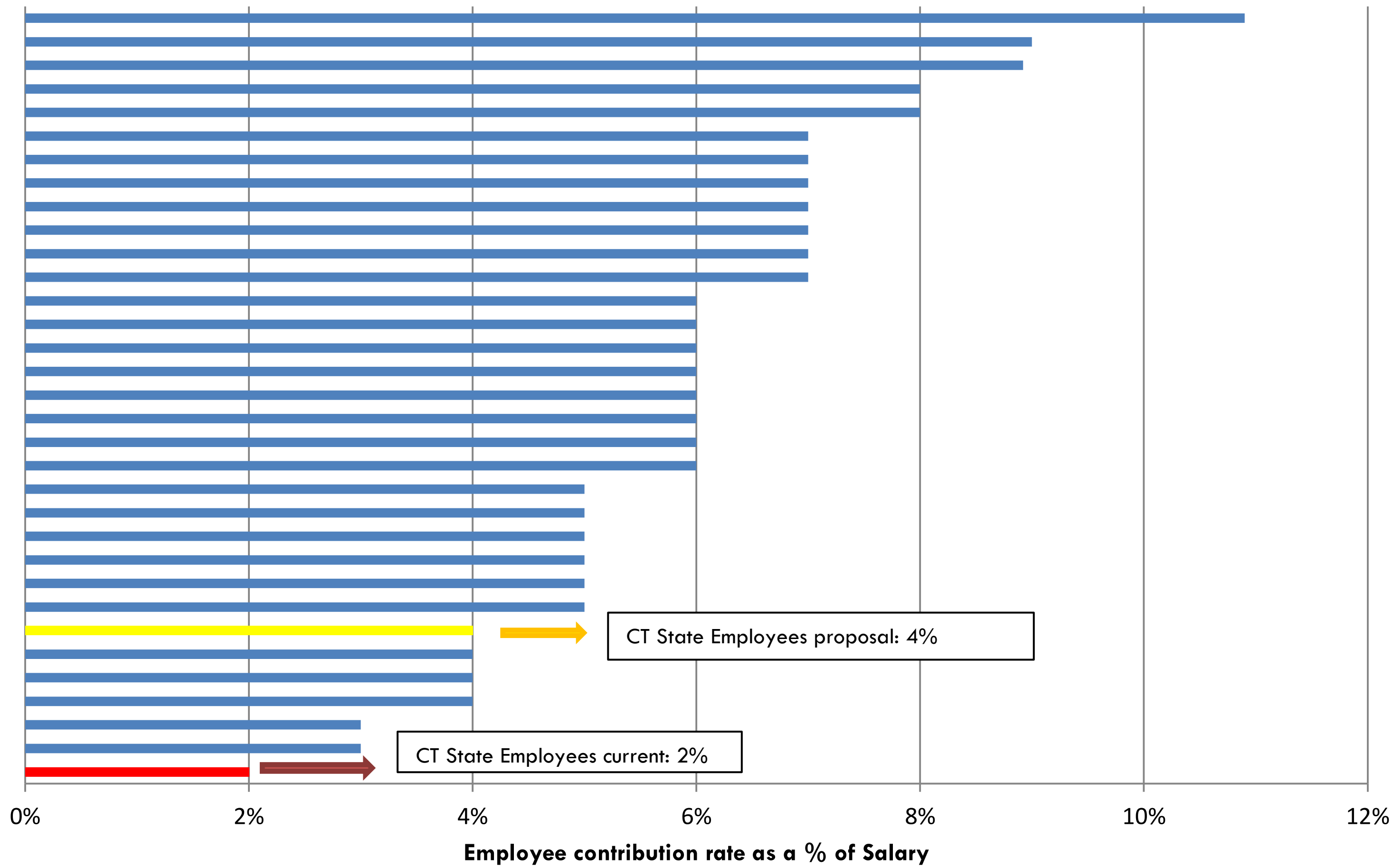
Pension Savings of $1.3B Over 5 Years

State Projection vs. Independent Assessment By Source



Source: CT Estimate of Total Savings data (in blue) based on analysis by the state's consulting actuaries included in the 2017 SEBAC Agreement Savings Estimates. Pew worked with independent actuaries to provide an independent assessment of the state's estimates, broken down by source; these figures are presented in the right column for each year. Estimates do not include the impact of changes to overtime due to data limitations.

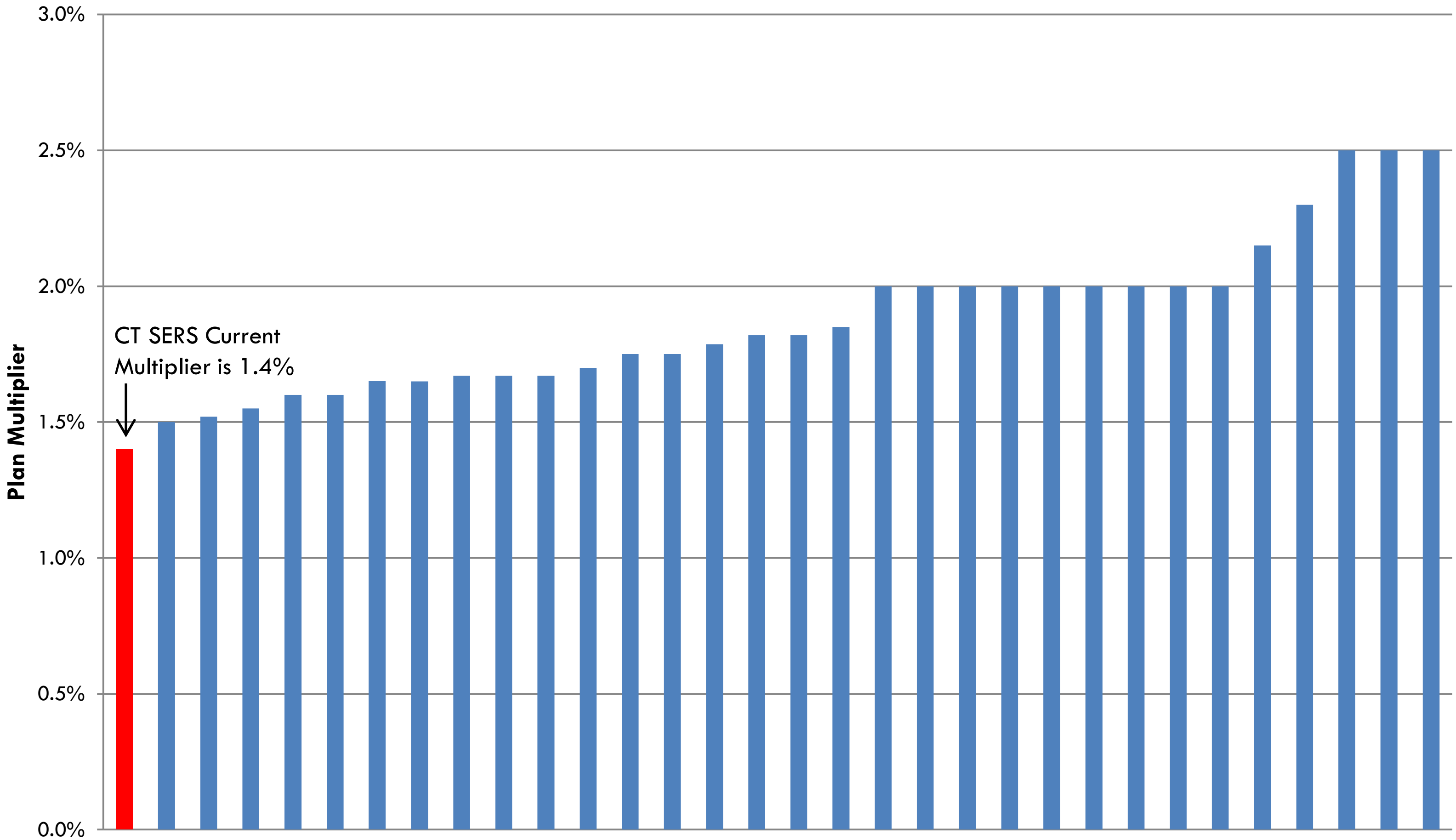
SERS Reports Lowest Employee Contribution Rate Among State Defined Benefit Plans…



Notes: The average multiplier for examined plans was 1.87%; CT State Employees is lower at 1.33%. Plans included in this analysis meet the following criteria: the latest defined benefit tier, participate in Social Security, and for state employees.

…But Also the Lowest Benefit Multiplier for DB Only Plans

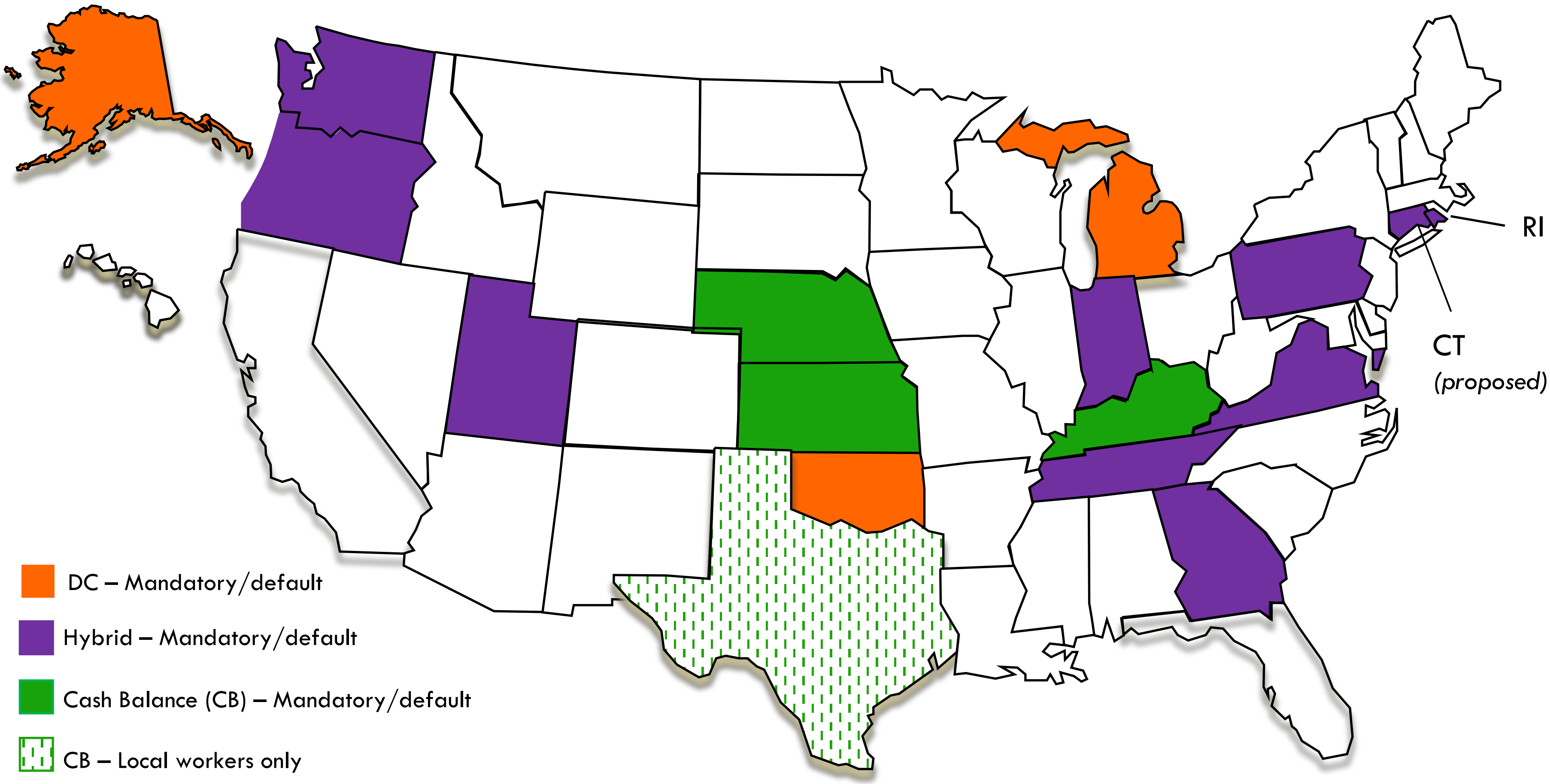
(the percentage multiplied by salary and years of service to calculate the pension benefit)



The average multiplier for examined plans was 1.87%; CT State Employees Tier III is lower at 1.4%. Plans included in this analysis meet the following criteria: the latest defined benefit tier, participate in Social Security, and for state employees.

50 State Data on DC and Hybrid Plans

15 states currently have mandatory or default alternative plans for at least some workers

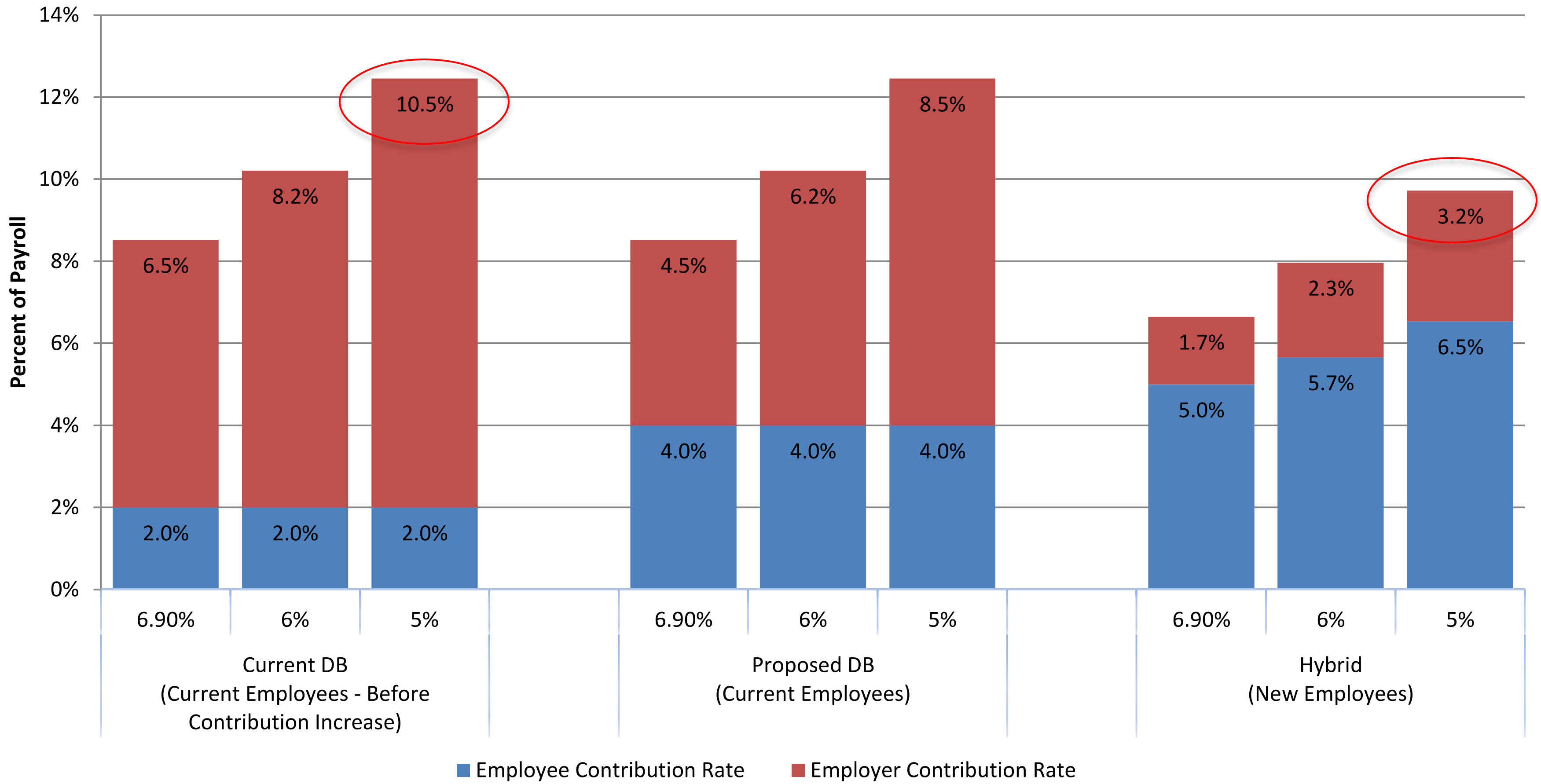


Notes:

- Data from NASRA and NCSL also make note of optional alternative states plans in the following states: Colorado (DC), Florida (DC), Montana (DC), North Dakota (DC), Ohio (DC and hybrid), and South Carolina (DC). In cases where a state has more than one alternative plan, the plan type with the greater number of participants is marked on the map. Texas provides a cash balance plan to over 400,000 local workers through the state's Texas Municipal Retirement System and Texas County and District Retirement System.

Sensitivity Analysis: Defined Benefit Contribution Rates at Different Rates of Return on Investments

New Plan Reduces Cost and Risk by Over 50%



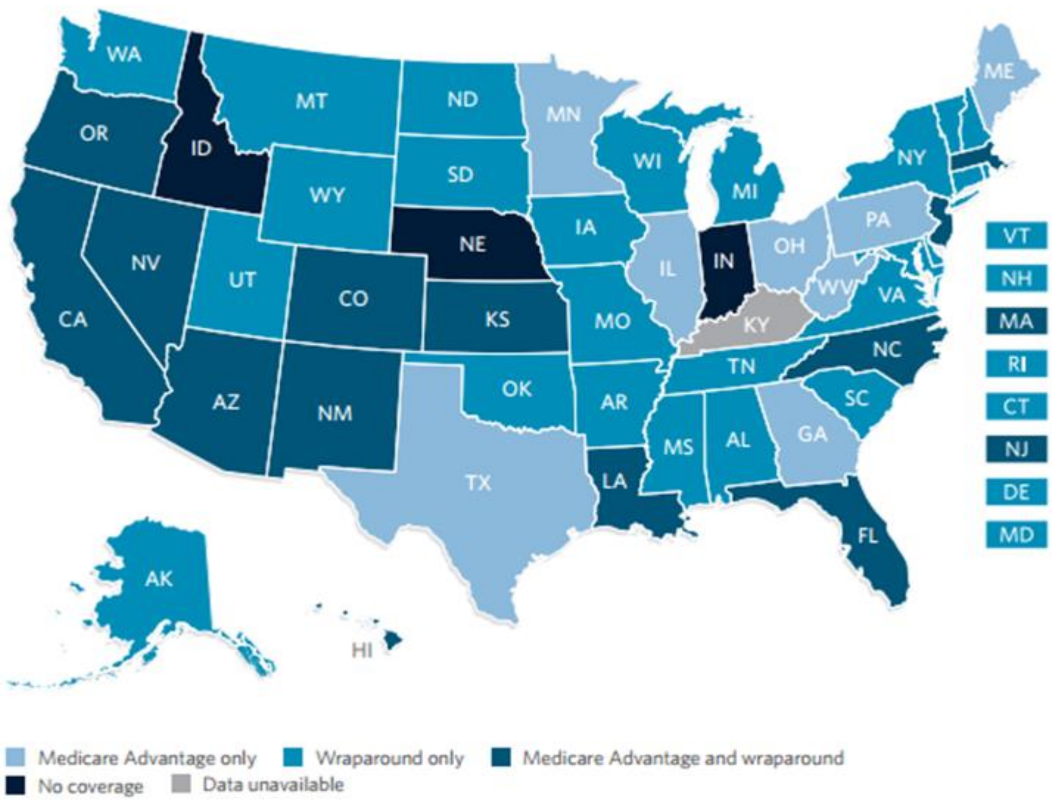
Note: Assuming a discount rate based on US Treasury securities (3.7%) the total cost would be 16.01% of pay for the current DB and 13.44% of pay for the hybrid. The state's cost is estimated to be 14.01% and 6.44% (current and hybrid).

Move to Medicare Advantage Follows Trend

Figure 9

States' Methods for Covering Medicare-Eligible Retirees Vary

Types of health coverage



- 21 states have adopted Medicare Advantage for their state employee OPEB plans.
- Represents 95% of Retiree Health and over half of Total Health Care Savings
- Savings for the first two years based on contractual commitment
- New provider (UHC) has track record of working with other states and generating savings over time.

Sources: Pew's *State Retiree Health Plan Spending* paper (http://www.pewtrusts.org/~/media/assets/2016/09/state_retiree_health_plan_spending.pdf); NCSL; Savings data are from the State and their consulting actuaries

Medicare Advantage Savings

Savings Include Discounted Prescription Drug Pricing

STATE OF CONNECTICUT

Budget Projections - Fiscal Years Ending June 30

AGGREGATE - STATE MEDICARE RETIREES: MEDICARE ADVANTAGE WITH PRESCRIPTION DRUG (INCREASED RETIREE POPULATION)

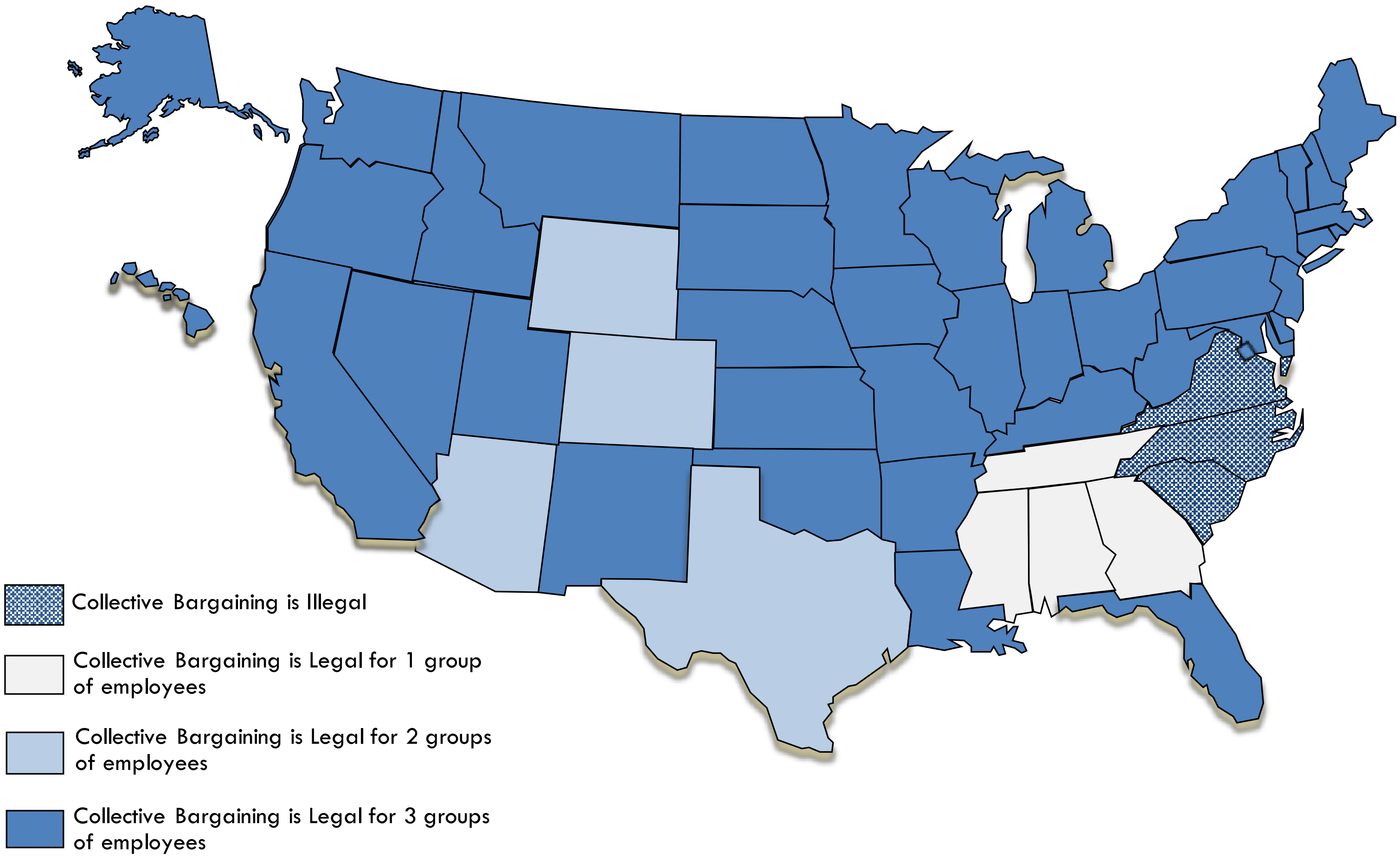
	Projections				
	2017	2018	2019	2020	2021
Medicare Advantage Premium (MA Component)	N/A	$22,100,000	$45,200,000	$56,000,000	$67,200,000
Medicare Advantage Premium (PD Component)	N/A	68,400,000	151,100,000	175,700,000	189,900,000
Medical Claims - Anthem	$90,300,000	60,000,000	N/A	N/A	N/A
Medical Claims - Oxford	14,900,000	10,700,000	N/A	N/A	N/A
Prescription Drug Claims - CVS/Caremark & Silverscript	252,200,000	140,100,000	N/A	N/A	N/A
Prescription Drug Rebates - CVS/Caremark & Silverscript	(40,200,000)	(42,400,000)	N/A	N/A	N/A
EGWP Savings - Silverscript*	(70,300,000)	(62,100,000)	(9,400,000)	N/A	N/A
ASO Fees - Anthem	11,400,000	5,900,000	N/A	N/A	N/A
ASO Fees - Oxford	1,400,000	700,000	N/A	N/A	N/A
ASO Fees - Silverscript	6,600,000	3,400,000	N/A	N/A	N/A
ACA Fees	100,000	100,000	100,000	N/A	N/A
Medicare Part B and D Reimbursement	64,900,000	69,200,000	74,500,000	80,200,000	86,300,000
Administrative Fees	1,100,000	1,100,000	1,200,000	1,200,000	1,200,000
Dental Premium - CIGNA	17,900,000	19,400,000	21,200,000	23,100,000	25,200,000
Medicare Retiree Expense Total	**$350,300,000**	**$296,600,000**	**$283,900,000**	**$336,200,000**	**$369,800,000**
Prior Projection	**$338,500,000**	**$359,300,000**	**$413,800,000**		
Change ($)	**11,800,000**	**(62,700,000)**	**(129,900,000)**		
Change (%)	**3.5%**	**-17.5%**	**-31.4%**		

Medicare Retiree General Fund Appropriation	2017	2018	2019	2020	2021
Total	**$335,980,000**	**$281,080,000**	**$266,940,000**	**$317,720,000**	**$349,640,000**
Prior Projection	$324,580,000	$344,340,000	$397,480,000		
Change ($)	11,400,000	(63,260,000)	(130,540,000)		
Change (%)	3.5%	-18.4%	-32.8%		

* Prior to CY 2017, EGWP reinsurance payments were paid in one lump sum seven months after the end of the calendar year. Effective CY 2017, reinsurance payments will be made on a monthly basis, with final reconciliation after the end of the calendar year. This will create a temporary cash flow advantage in FY 2017 and FY 2018, as shown above.

Projected Savings of $77M in FY18 and $144M in FY19 include negotiated price discounts from current vendor

Legality of Collective Bargaining for Public Employees in the United States

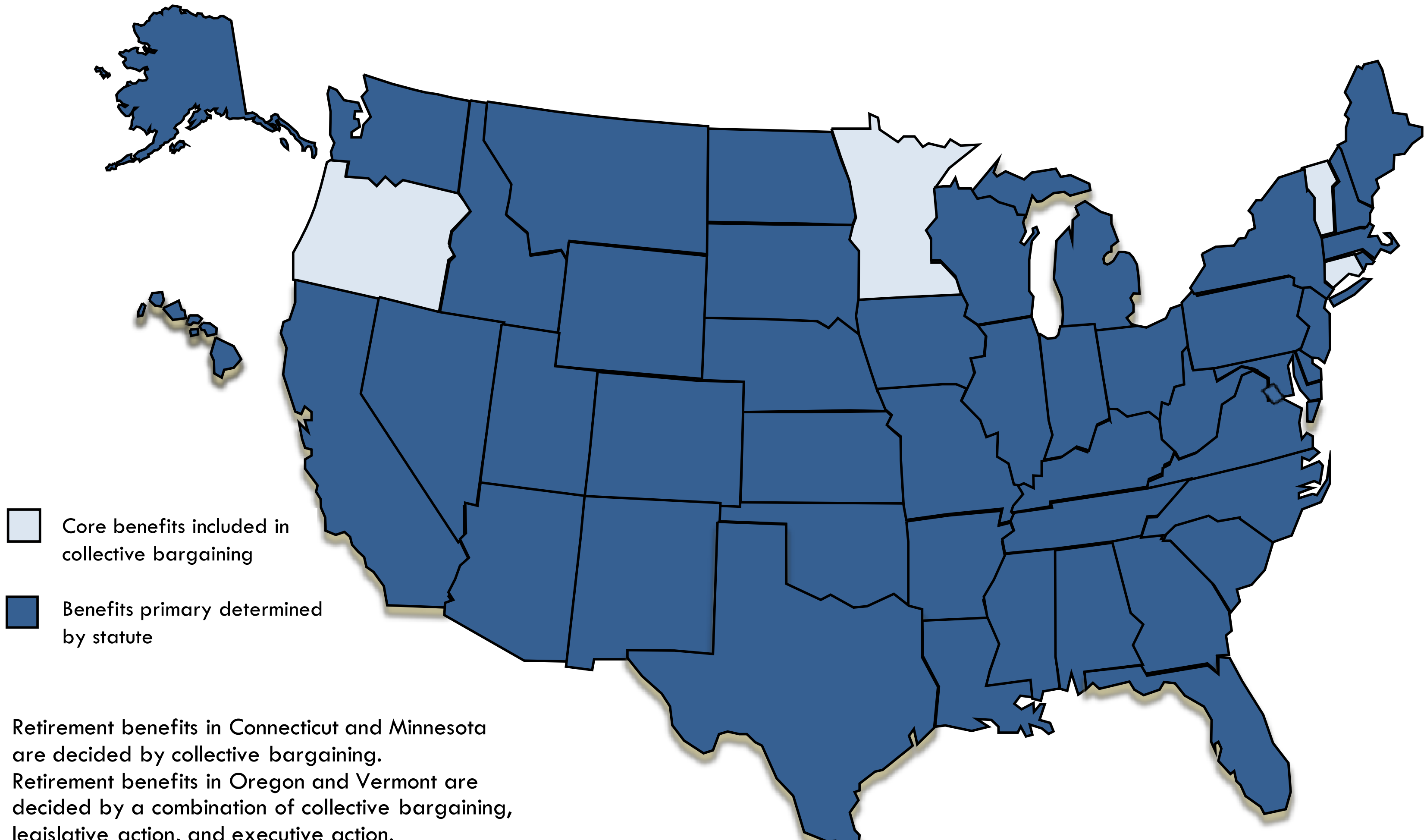


Groups of employees include police, fire, and teachers.

Source: Center for Economic and Policy Research's paper, *Regulation of Public Sector Collective Bargaining in the States*

How Pension Benefits are Set for State Employees

Collective bargaining does not determine state employee benefits in most states



Retirement benefits in Connecticut and Minnesota are decided by collective bargaining.
Retirement benefits in Oregon and Vermont are decided by a combination of collective bargaining, legislative action, and executive action.

Source: State of Connecticut and the Pew Charitable Trusts reached out to legislative research offices and personnel agencies. Due to the complicated nature question, respondents were advised to broadly generalize their response if necessary (e.g., choose the answer that would apply to the most employees or under the must typical circumstances). Teachers and municipal workers are not represented in this analysis.

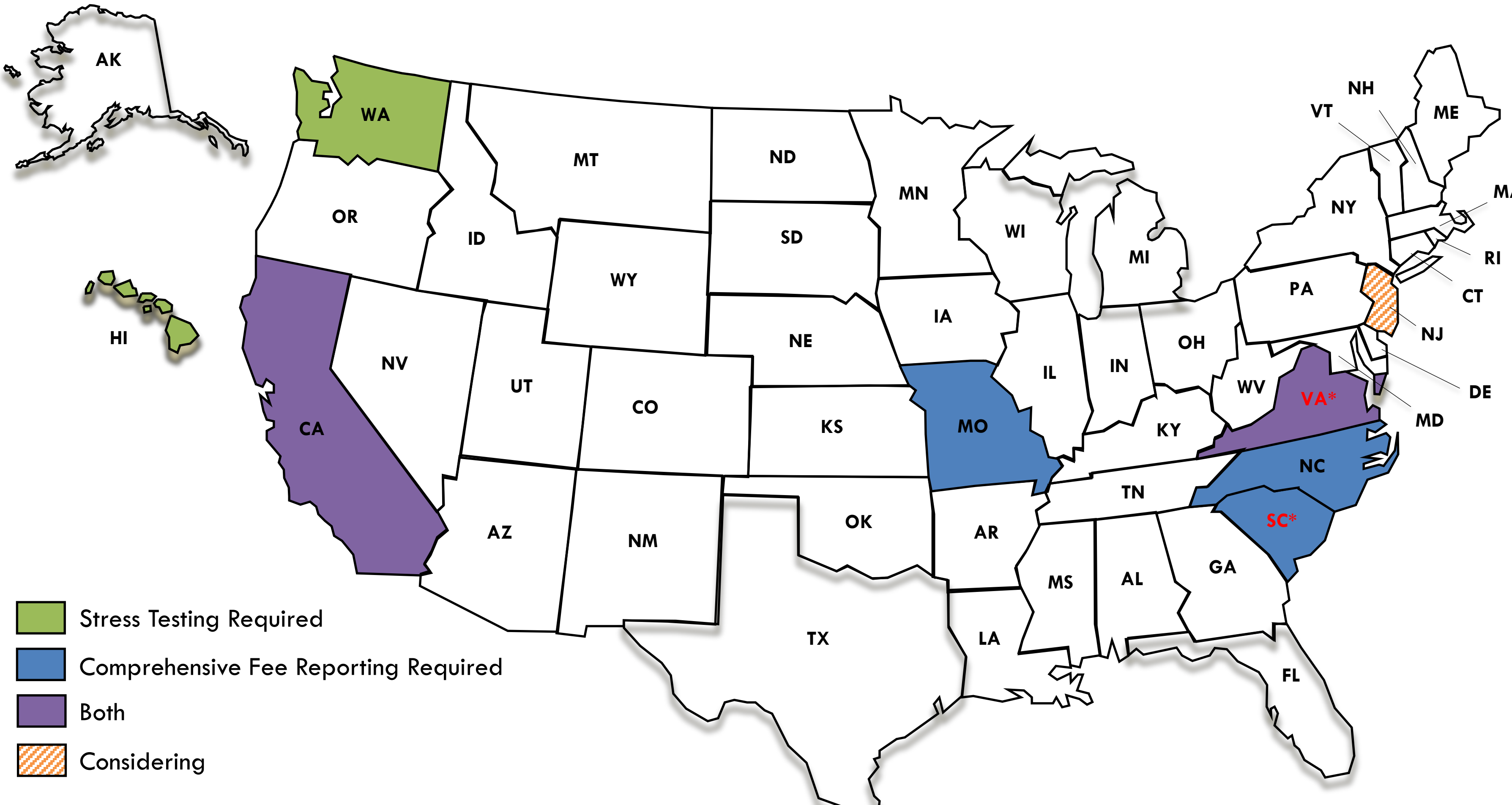
Policy Considerations

- Commission a 50 state comparative study of retirement benefits and policies, as well as an independent actuarial assessment, to help ensure Connecticut is in line with peer states.

- Require stress test analysis of all retirement plans as part of regular reporting to determine how the plan would perform during a financial crisis.

- Establish a policy to fully disclose alternative investment fees in order to increase transparency and control costs.

States That Have Adopted Stress Testing and Investment Fee Transparency Measures*



***Note:** South Carolina and Virginia also recently commissioned a 50 state comparative study of retirement benefits and policies

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