New Jersey State Pension Systems

Disclosure
Funding
Accounting

April, 2007

Agenda

- Introduction/Overview
  - Disclosure
  - Actuarial Methodology
  - Budget Implications
  - Funding
- Lessons of the past
  - The "Gimmicks"
- System Status
- Governor Corzine's Funding Policy

Disclosure Vehicles

- Monthly
  - Pension Boards receive financial statements describing plan assets, changes in assets, investments and balance sheets; these are public documents; Investment Council receives similar reports
- Annual
  - Each Board receives a detailed valuation report containing full disclosure of plan assets, liabilities and changes based on June 30th of each year

Who Delivers Disclosure

- Monthly statements are prepared internally by the Division of Pensions with data provided by Division of Investments
- Annual Valuation reports are prepared by independent actuaries selected through a competitive bid process with Board participation
- External auditor also retained to ensure accuracy in actuarial reporting
- All are subject to examination by the State Auditor

Actuarial Assumptions

- Key assumptions driving liability estimates include:
  - Life Expectancy
  - Size of Workforce
  - Career Service
  - Salary Growth
  - Inflation

“Managing” Key Assumptions

- Each Board receives a triennial report examining plan experience versus assumptions
- Only one variable, the assumed rate of return, is established by the Treasurer
- Changes in these assumptions are not frequent but reflect actual experience trends

Budget Implications

- The actuarial report delivered as of June 30, 2006 will affect normal contribution requirements for FY '08 in most cases; PFRS actually will impact a year later
- The actual budget appropriation may or may not reflect the actuarially developed required contribution
- Any budgeted amounts are fully disclosed through the budget process

"Transparency" +

- In addition to all the previously mentioned documentation, financial disclosure includes:
  - State's Comprehensive Annual Financial Report (CAFR)
  - Division of Pensions & Benefits CAFR
  - Annual Reports for Each Plan

Funding Requirements are Dynamic and Change Over Time

- Normal Cost: present value of service earned for a particular year
- Accrued Liability: present value of all past service
- Unfunded Accrued Liability: The difference between assets and liabilities and amortized over a period of time

Key Funding Drivers

- Gains and losses are recognized, or smoothed, over “five years” to limit volatility
- Actuarial value of assets versus actuarial liabilities determines:
  - Funding status
  - Need for Employer Contributions

Funding Requirements

- Based on Generally Accepted Principles by the Government Accounting Standards Board
  - Same basis as all public sector plans
- Suggestions that alternatives be used are totally inappropriate

Where Are We Today?

- Late '90s and Early '00s
  - Internet Bubble Burst
  - Resultant Negative Investment Returns
  - Overall Downturn in the Economy
- System Surpluses Depleted
- Return of Employer Contributions
- Budget Shortfalls Aggravate Contribution Issue

Contributing Factors

- Legislative initiatives detracted from long-standing, sound pension funding policies
- Generous benefit enhancements
- An "unexpected" downturn in market conditions

Pension Revaluation Act

L. 1992, C. 41

- Changed the methodology by which plan assets were measured from book value to market-related value.
- Increased the plans' interest rate assumption rate from 7 percent to 8.75 percent.
- Resulted in a $733.4 million and $785.7 million reduction in State and local employer pension contributions for fiscal years 1992 and 1993, respectively.

Pension Reform Act

L. 1994, C. 62

- Revised the actuarial funding methodology for the State plans from the entry age normal method to the projected unit credit method.
- Reduced State and local employer pension contributions to the plan by $547.4 million and $946.8 million for fiscal years 1994 and 1995, respectively.

Pension Security Plan

L. 1997, C. 115

- Provided for the issuance of $2.75 billion in pension obligation bonds to finance the plans' outstanding unfunded pension liabilities.
- Increased the assets of the plans to market value.
- Allowed the use of surplus pension assets to offset employers' annual normal contributions to the pension system.
- Resulted in either complete or partial reductions in the State's and local employers' otherwise required normal contributions to the plan for fiscal years 1997 through 2004.

Contribution Phase-Ins

L. 2003, C. 108

- Allowed for the phase-in of local employer pension contributions.
- In conjunction with this law, the appropriations act provided the State with authorization to use the BEF to cover a portion of its contribution requirements for PERS and TPAF.
- From FY 2004 through FY 2006, contributions were reduced by $3.9 billion, $3 billion for the state and $.9 billion for locals as compared to actual contributions made totaling $.92 billion, $.31 billion for the state and $.61 billion for locals.

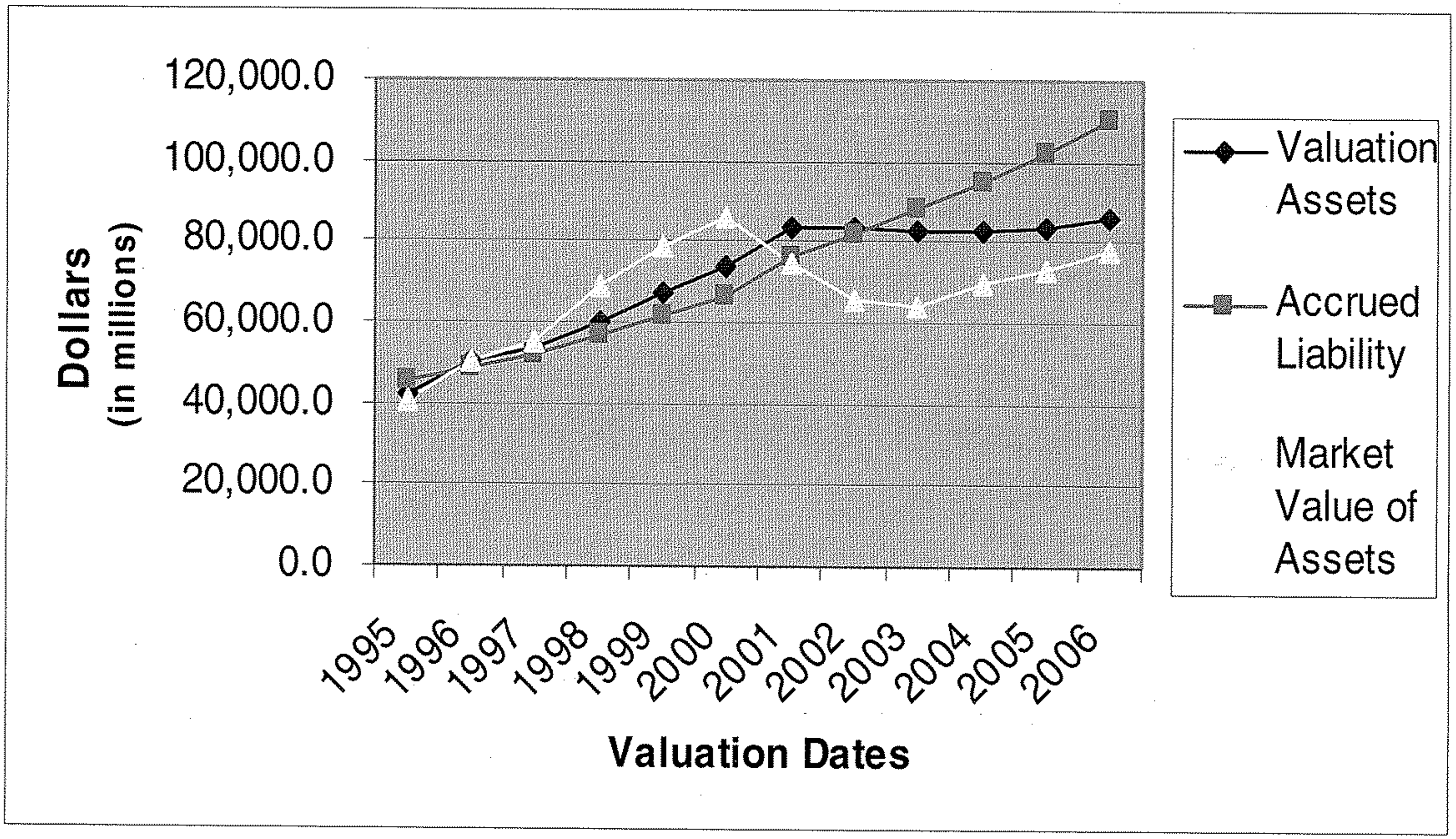
Benefit Enhancements

- L. 2001, c. 133: Increased PERS and TPAF pensions by 9.09 percent, while increasing pension liabilities by over $4.2 billion.
- L. 1999, c. 428: Provided enhanced pensions benefits to members of the PFRS, increased pension liabilities by over $.5 billion.
- Numerous other pieces of legislation were enacted that provided extraordinary pension enhancements to prosecutors, workers compensation judges and others. Cumulatively, since 1999, these enhancements increased State and local pension liabilities by over $6.8 billion.

Benefit Enhancement Fund

- Benefit Enhancement Funds (BEF) were created in both the PERS and TPAF with the enactment of the law providing retirees with a 9.09 percent pension increase (L. 2001, c.133).
- They were created by of increasing pension system assets to market value.
- The intent behind the BEF was to be the source of funding for the additional annual pension costs arising from the 9.09 percent pension increase, thereby keeping the benefit increase cost-neutral.
- The BEF was first used to offset regular State pension contributions in FY'04, and has since been exhausted.

System Status



Governor’s Funding Policy

- State has a moral obligation to fund delivery
- The FY ’07 Contribution of $1.1B
- Recommendation for FY ’08 is $1.2B
- Previous nine years totaled only $860.8M

Governor's Recommendations