DEPARTMENT OF THE TREASURY
FY2012 INTERDEPARTMENTAL QUESTIONS

DISCUSSION POINT 1

Economic Development Authority

FY 2012 budget language provides that the Liberty Science Center (LSC) appropriation is to be used not only for debt service, but also for operational costs of the LSC. The proposed budget language provides that the amount of operational support for the LSC is to be determined by the State Treasurer pursuant to an agreement between the State Treasurer and the LSC. In FY 2011 both general operating support and funding for educational services provided by the LSC is allocated through the Department of Education. In FY 2011, an original appropriation of $1.35 million for educational services is projected to be supplemented by $3.6 million for general operating support, but the Administration has already exceeded that projection, having approved $4.3 million through April 30, 2011. The recommended appropriation of $11.073 million for FY 2012 includes approximately $8.1 million for debt service (an increase of $581,000) and $3.0 million in additional funding to support the operations of the Liberty Science Center. The Department of Education's budget also includes $1.3 million for LSC educational services.

In November 2008, the Jersey City Council approved a bridge loan of $2.5 million (about 10 percent of the Liberty Science Center's operating budget) from the city to the Liberty Science Center. The balance of the loan was due by December 31, 2010.

QUESTION 1

What percentage of LSC's annual operating budget is now and is projected to be subsidized by State funds? Has an agreement between the State Treasurer and the Liberty Science Center establishing terms and conditions for State operating support for LSC been finalized? If so, please summarize its key provisions and provide a copy. If not, please summarize the key provisions that the Treasurer anticipates will be included in the agreement. Will the total operating subsidy to LSC be limited in the agreement in any way, e.g., to a level no greater than that provided in FY 2011? Will the agreement include restrictions on LSC spending and other decisions, e.g., employee compensation levels, procurement of goods and services, similar to those the Governor believes are appropriate for independent State authorities? Given that the amount of operating subsidy in FY 2011 already exceeds earlier projections, is the amount recommended for FY 2012 adequate? What is the status of the repayment of the loan made by Jersey City to the Liberty Science Center? Did the State assume responsibility for the loan?

ANSWER 1

For FY2011, approximately one-third ($6.15M) of the LSC's operating budget will be provided by the State.

A grant agreement between the Department of Education and the LSC has been in place for a number of years for the provision of educational services to school districts. In

FY2011, budget language was added to provide additional support for operational costs. To have better oversight over that level of operational support, an agreement between the Treasurer and the LSC that will identify terms and conditions for the State to support facility and infrastructure operating costs is being developed and will be finalized prior to the commencement of FY2012. The agreement with Treasury is expected to include provisions that will allow the Treasurer to review bills, examine financial records, etc.

The total of the State support provided through the grant agreement with Education and the pending agreement with Treasury is expected to total $4.95M in FY2012. The total anticipated support for FY2012 is less than the amount provided in FY2011, and the Department is working with the LSC on a number of initiatives to enable the LSC to reduce its amount of State support.

The State did not assume responsibility for the loan from Jersey City. Rather, the provision for re-payment has been deferred.

DISCUSSION POINT 2 A

Pensions

The Governor's pension reform proposal (Senate Bill No. 2705 of 2011 and Assembly Bill No. 3796 of 2011) revises the pension funding formulas in order to reduce future retirement benefits of current active employees. In addition, it increases employee contributions in order to decrease the employer contributions to four State-administered defined benefit retirement systems: the Public Employees' Retirement System (PERS), the Teachers' Pension and Annuity Fund (TPAF), the State Police Retirement System (SPRS), and the Judicial Retirement System (JRS). Among other things, the pension reform proposal reduces the TPAF and PERS benefit factor by 15.4 percent by changing it from 1/55 to 1/65, increases the number of years of service required to qualify for early retirement benefits from 25 to 30 years, and increase employee contributions from 5.5 percent of compensation to 8.5 percent of compensation. For PFRS and SPRS members with 25 years of service, the pension reform proposal decreases the percentage of salary upon which a pension is based from 65 percent to 60 percent. It also suspends the adjustment on pension COLAs for all systems and all retirees.

QUESTION 2 A

What is the present value of the savings estimated to be achieved by reducing the TPAF and PERS benefit factor and what is the estimated impact it will have on the unfunded actuarial accrued liability in 5 years, 10 years, 15 years, and 20 years? What is the present value of the savings estimated to be achieved by increasing the TPAF and PERS number of years required to qualify for benefits and what impact will it have on the unfunded liability in 5 years, 10 years, 15 years, and 20 years? What is the estimated value to each system of increasing the TPAF, PERS, and SPRS employee contribution and the total combined value and by how much will that reduce the employer contribution to each system? What is the estimated value of reducing the percentage of salary upon which a pension is based from 65 percent to 60 percent for PFRS and SPRS retirees with 25 years of service?

ANSWER 2 A

The Governor's proposed pension reforms are designed to improve the financial stability of the State-administered pension plans for all participants as well as create a more affordable plan for participating employers. Without these reforms, the aggregate funded level of the plans is projected to further deteriorate from their current 62 percent funded level to 55 percent by fiscal year 2041. The unfunded accrued liabilities are expected to increase from a current $53.8 billion to over $183.1 billion over this same time period. With the Governor's proposed reforms, the aggregate funded level of the plans is expected to improve to over 90 percent funded by fiscal year 2041, with an anticipated decrease in the unfunded accrued liabilities to $28.3 billion.

It is difficult to answer the specific question about the distinct impact of each element of the Governor's reform proposal because many of the reforms are interrelated. Therefore, the impact of a specific reform assessed by itself will not reflect the actual impact when valued as a group with the other reforms. To put it another way, the impact of each additional reform is not additive (i.e. the sum of the projected impact of the reforms, when added together on an individual basis, will not equal the projected impact when all reforms are assessed as a group). Consequently, evaluating each element of the Governor's pension reform proposal separately would provide projected results that will not be typical of what will occur and, may lead someone to an incorrect conclusion of the true value of that reform element.

While we cannot provide the value or impact of each element of the reform proposal, what we can provide is a ranking of the relative value of the reforms. The reform that has the greatest impact is the elimination of future COLA increases for all active and retired members. Listed below are the other reforms in a relative rank order from higher to lower savings:

- Increasing Early Retirement and Post Retirement Medical Eligibility to 30 years with increasing reduction factor to 3% per year (this includes basing a PFRS and SPRS pension on 60% of final salary instead of 65% with 25 years of service)
- Decreasing the benefit formula for future service to n/65 (all PERS and TPAF employees)
- Increasing employee contributions to 8.5% (all PERS, TPAF, SPRS and JRS employees)
- Increasing retirement to age 65 (employees < 25)
- Increasing final average earnings period to 5 yrs and 3 yrs (employees < 25)

DISCUSSION POINT 2 B

Reducing the Unfunded Actuarially Accrued Liability (UAAL) significantly in the short term may require increasing employer and/or employee contributions into the system, achieving higher investment returns, and reducing expenditures out of the system. Revising the funding formulas and making changes in accordance with the Governor's pension reform proposal will have a relatively minor impact on the condition of the pension fund in the short term and an increasing impact over the long term.

QUESTIONS 2 B

What measures can be taken in the short term to achieve an immediate, significant impact on the revenues and investment returns into the pension funds and expenditures out of the pension funds? By how much would the market have to improve to reduce the UAAL in the annual actuarial evaluation to achieve an 80 percent funded level within ten years, all other things being equal? By how much did the FY 2011 15 percent increase in investment value improve the funded ratio of the combined pension system? By how much would the State have to increase its pension contributions beyond the current statutory mandate under P.L.2010, c.1, combined with a realistic investment return, to achieve an 80 percent funded level within 10 years? By how much would the UAAL be reduced in 10 years and 30 years if the retiree COLA were suspended indefinitely?

ANSWER 2 B

The only possible way to achieve an immediate, significant impact on revenues in the short-term is to significantly increase employer and employee contribution requirements. The Governor's reform proposal does include an increase in employee contribution rates for members of PERS, TPAF, SPRS and JRS to 8.5%. The goal for investment returns is to have an investment strategy in place to achieve the best risk adjusted returns possible, which we do, in the short- and long-term. We cannot recommend any short-term actions that would significantly impact expenditures out of the pension funds. However, adoption of the Governor's reform proposal will result in no automatic COLA increases and lower future benefit levels which will slow down the rate of growth of expenditures on a longer-term basis.

Assuming a seven year phase-in of State contributions pursuant to P.L. 2010, c.1, to reach an 80% funded ratio on an actuarial basis in 10 years for the State-funded systems, a 21% per year return over the entire 10 year period would be required. Even under that scenario, all the systems would not be at or above 80%, but in aggregate the funded ratio would be above 80%.

The Division is unable to provide the impact of the FY2011 15% increase in investment value on the funded ratio since the actuarial calculations required to determine the FY 2011 impact of investment returns over (or under) the assumed rate of return on pension system assets will not be performed until after June 30, 2011.

The actuaries for the pension system compile their actuarial valuation reports as of June 30th of each year. It is on this date that they compare the actual experience of the pension plans during the plan year to the assumptions they utilize to calculate the value of the pension funds' liabilities. Rates of return in excess of the current assumption of 8.25 percent, considered an actuarial gain, will have the impact of reducing the UAAL. However, the rate of return assumption (or, the discount rate) is only one of a number of assumptions used by the actuary to compute the liabilities of the plans, and the aggregate actuarial gain or loss resulting from the comparison of all the assumptions to actual plan experience will determine the impact on the UAAL.

The effect of the market value of plan assets on the UAAL is further mitigated by the five year smoothing asset valuation method used by the actuaries. Under this asset valuation method, only 20 percent of the difference between the market value of plan assets as of June

30th compared to the anticipated actuarial value of assets is recognized in determining the UAAL in any plan year.

Over the 10-year period, assuming an 8.25% investment return, the State would have to contribute 190% of the current statutory required annual contribution each year to reach an 80% aggregate funded ratio in 10 years. This would result in an additional aggregate contribution of $15.3 billion ($53.1 billion as compared to $37.8 billion) over the 10 year period.

If the COLA was suspended for all current and future retirees, the projected UAAL reduction for the specified periods would be as indicated in the following table:

(In Millions)

	FY2021	**FY2041**
State	$ (20,683)	$ (63,461)
Local	$ (9,709)	$ (34,626)
Total	$ (30,392)	$ (98,087)

DISCUSSION POINT 3 A

State Health Benefits

The FY 2012 Governor's Budget Summary outlines the Governor's plan for health care benefit reform for active employees. Additional details were subsequently outlined in several news reports. According to theses sources, the plan proposes to (1) require employees to pay 30 percent of premium for health care benefits by 2014 beginning with a ten percent required premium share for the first six months of FY 2012 increasing to 17 percent in the last six months of FY 2012, increasing to 20 percent in FY 2013, and 30 percent in FY 2014; (2) provide more options in health plans; (3) raise the required years of service to qualify for employer-paid post-retirement health benefits from 25 to 30 for those with less than 25 years of service; (4) eliminate NJDIRECT 10; and (5) modify benefits such as co-pays for primary, specialist, and emergency room visits, deductibles for out-of network providers, coverage percentile for reasonable and customary out-of-network services, and in-network out-of-pocket maximums.

QUESTION 3 A

Please describe each of the provisions of the proposed Governor's health care reform initiative and how it would be implemented. Please provide an estimate and the assumptions made to derive the estimate, of the State, higher education, local, and school employee savings anticipated to be achieved by requiring employees to pay an increasing percent of their health care premium each year between now and full implementation in 2014. Please describe how the present value of the unfunded post-retirement medical benefits obligation would be changed by extending the number of years to qualify for post-retirement medical benefits from 25 to 30 years of service. How many and what percentage of the State workforce would be more than 65 years of age if required to work thirty years before becoming eligible for post-retirement medical benefits? What are the estimated savings and the assumptions used to determine the savings from eliminating NJDIRECT 10 for actives and retirees? How will the elimination of NJDIRECT 10 affect NJDIRECT 15 in terms of enrollment, utilization, and risk pool? Please provide the proposed plan to modify co-pays for primary, specialty, and emergency room visits; deductibles for out-of-network providers; coverage percentile for reasonable and customary out-of-network services; and in-network out-of-pocket premiums. Please provide an estimate of the savings in FY 2012, FY 2013, and FY 2014 from modifying benefits and the assumptions used to derive these savings. Will the federal Patient Protection and Affordable Care Act and Health Care Education Reconciliation Act have an impact on the State, as an employer, and on State employees by 2015? Please provide an estimate of the number of State employees who may qualify for federal health care benefits under the national health care reform law as result of the changes implemented by the State. What percentage of SHBP/SEHBP membership does this represent? To the extent that those who qualify for federal benefits shift out of the SHBP/SEHBP, how will this reduce the size of the SHBP/SEHBP in terms of membership and costs? How will the national health care reform law provide coverage for these employees?

ANSWER 3 A

As stated in the Treasurer's response in the Senate Budget hearings, we have been engaged with the Legislature in constructive conversations that we are hopeful will meet our objective for viable health care reform.

DISCUSSION POINT 3 B

According to budget documents from the Division of Pensions and Benefits, the FY 2012 Governor's Budget includes an appropriation for the 1.5 percent member share for State health benefits in addition to the health care reform premium sharing requirements. Thus, employee contributions, in accordance with the proposed FY 2012 Governor's Budget, include the current 1.5 percent member share and an additional 10 to 17 percent premium share in FY 2012 which is equivalent to an 18 to 25 percent premium share requirement in FY 2012.

QUESTION 3 B

What are the underlying assumptions in the proposed health care reform initiative for employee contributions in FY 2012, FY 2013, and FY 2014? Are the employee premium share requirements in the current proposal in addition to the current 1.5 percent member share or is the expectation that the employee contribution will shift from a member share to a premium share requirement entirely, the maximum of which is 30 percent in FY 2014?

ANSWER 3 B

The underlying assumption regarding employee premium contributions under the Governor's Health Care Reform Initiative is that the current 1.5% of salary contribution arrangement will be replaced by an arrangement where employee contributions are based on a percentage of the cost of the plan option chosen and the employee's coverage tier (e.g., single, family, etc.). The total premium share will be phased in to obtain the maximum of 30 percent.

DISCUSSION POINT 3 C

According to the Plan Year 2011 Rate Renewal Recommendation Report prepared by Aon Consulting for the State, local, and school employee groups, the SHBP (State and Local) and the SEHBP active and retiree costs for medical health care and prescription drugs are projected to rise by 6.9 percent for the SHBP State employee group, 11.7 percent for the SHBP local government employee group, and 5.7 percent for school employees. For comparative purposes, Aon indicates that their industry surveys show an increase of 10 to 11 percent for health care costs for 2011. Aon suggests that a significant portion of the increase in health care costs for the SHBP/SEHBP can be explained by New Jersey mandated benefit claims such as Autism (0.4 percent of costs or $4 million per year) and chiropractic services (0.3 percent increase in costs or $4 million per year), and national health care reform provisions under the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act, specifically the provisions relating to coverage of: (1) dependent children to age 26 which is estimated to increase employee and retiree costs by a combined 0.5 percent of costs with a total estimated annual cost of $6 million to the State Group; (2) the elimination of maximums on benefits which is anticipated to increase NJDIRECT costs by 0.1 percent, or $1 million, annually; and (3) the removal of the mental health/substance abuse maximum benefits which is anticipated to increase projected plan costs by 0.5 percent, or $6 million. Other factors include medical inflation and higher claims. According to Aon, the provisions relating to the Early Retiree Insurance Program (EERP) could provide up to $25 million in savings to the SHBP, but Aon is “not making any adjustments to the plan due to the uncertainties with the EERP process .i.e., no regulations have been issued”.

QUESTION 3 C

Please identify and rank in descending order the 7 most expensive health benefit coverages or mandated benefits enacted by State statute during the past 10 years; the estimated cost of the coverage in the last 12-month period; and the percentage of premium reduction that would result from removal of the mandate.

ANSWER 3 C

As stated in the Treasurer’s response in the Senate Budget hearings, we have been engaged with the Legislature in constructive conversations that we are hopeful will meet our objective for viable health care reform.

DISCUSSION POINT 4

Property Rentals

In FY 2011, the Governor proposed replacing State Police civilian security guards at low risk facilities with contract service guards. Those State Police civilian security guards who were displaced were to be reallocated and reassigned to high risk facilities to reduce overtime costs. The initiative was anticipated to save $467,000, all of which is to be transferred to the Property Rentals account in FY 2011 and used to offset leasing costs.

QUESTION 4

Please provide a status report of the State Police civilian security guard initiative. What savings were achieved and how much was saved by each component of savings, e.g., salaries, overtime, shift hours? Were any State Police civilian guards laid off and their positions filled by contract service guards? What vendor(s) are under contract to provide security services and for what contract period?

ANSWER 4

The Department of Law and Public Safety conducted an analysis regarding the possibility of privatizing the guard function performed by state employees. L&PS concluded that privatization of this function would result in additional costs rather than the achievement of savings.

Instead of privatizing guard functions, L&PS reported that it evaluated the "central monitoring" function from the RJ Hughes Complex, where staff utilized closed circuit monitoring to safeguard 30 external State sites. In FY 2011, L&PS transferred the responsibility to a private vendor, and the six (6) State security guards ceased performing all monitoring duties (as of September 18, 2010). L&PS reassigned the guards throughout the Office of State Governmental Security within the Division of State Police (one guard has since retired). By utilizing a private vendor for the central monitoring function the appropriation for the Central Monitoring Station was reduced by $350,000. The remaining savings of $117,000 was made up by reduced overtime costs due to security guard rescheduling: $30,000 in the Division of State Police; $87,000 in the State Capitol Joint Management Commission.

DISCUSSION POINT 5

Insurance and Other Services

The State is self-insured for Worker's Compensation payments made to State employees. Claims are funded through the Interdepartmental Accounts budget. State expenditures for worker's compensation claims are projected to increase from $87.3 million in FY 2011, which includes a supplemental appropriation of $13.6 million, to $101.2 million in FY 2012. This $13.9 million increase reflects $10.9 million in increased Workers' Compensation costs from the elimination of the Sick Leave Injury Program under P.L.2010, c.3 and $3.2 million resulting from an increase in medical costs.

QUESTION 5

Please explain how the $10.9 million increase to the Worker's Compensation program from the elimination of the Sick Leave Injury program was derived in terms of methodology and calculations, number of claims, cost of claims, and the costs and savings associated with conversion of SLI claims to workers' compensation claims, e.g., salaries and the billing and payment of medical claims.

ANSWER 5

Benefits paid under SLI are funded from the payroll accounts of each agency for up to one year of disability. SLI benefits are set at 100% of wages. After one year, benefits are derived from the worker's compensation fund. With the elimination of SLI, worker's compensation temporary disability benefits will be paid from the worker's compensation fund from the onset of disability. As prescribed by law, temporary worker's compensation benefits are capped at 70% of pre-injury wages. $10.7 million is 70% of the estimated $15.3 million that would have been paid under a continuation of SLI (SLI was $15.8 in and FY 10 and $15.8 in FY 09).