State of New Jersey

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State Treasurer

TO: David J. Rosen
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FROM: Andrew P. Sidamon-Eristoff ASE
State Treasurer

DATE: April 20, 2011

SUBJECT: Senate Budget Committee Follow-up

Senator Buono:

Question: Governor Christie is proposing to reform the pension system for public employees. Pages 47 and 48 of the Governor's FY 2012 Budget Summary outline some of the proposed changes. Please submit information on the distinct impact of each element of the Governor's reform proposal on the actuarially determined liability of the public employee pension funds system.

Answer: 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 its current 62 percent funded level to 55 percent by fiscal year 2041. The unfunded accrued liabilities are expected to increase from $53.8 billion currently to over $183.1 billion over this same time period. With the Governor's proposed reforms, the aggregate funded level of the plans are 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.

The Governor's proposed changes include the following:

Funding Provisions:

- Adopt a 30 year level dollar open ended unfunded liability amortization schedule.
- Reduce the regular interest rate from 8.25 percent to 7.5 percent as well as the interest rate on employee contributions to 4%.

Benefit Provisions:

- Eliminate COLA for all current and future retirees (all systems).
- Increase the employee contribution rate to 8.5% of pay for all members of the PERS, TPAF, SPRS and JRS.
- Change the benefit formula to N/65 for all future service for all members of PERS and TPAF. Eliminate the 9% increase provided in 2001 for future service accruals for a veteran's pension.
- For employees with less than 25 years of service and new employees, the following benefit provisions would apply:
    - Increase the retirement age for unreduced benefits in PERS and TPAF to 65.
    - Increase the early retirement eligibility from 25 to 30 years for PERS and TPAF.
    - Change the early retirement reduction to 3 percent a year from age 65 for PERS and TPAF.
    - Change the average final compensation from 3 to 5 years for all service for PERS and TPAF.
    - Change the average final compensation from 1 to 3 years for all service for PFRS and SPRS.
    - Change the PFRS and SPRS special retirement to 65 percent of average final compensation for 30 years, 60 percent for 25 years and 50 percent for 20 years
- Disability pension reforms.
- Return to employment after retirement reforms.
- ABP and DCRP distribution reforms.

Governance:

- Changes necessary to maintain Internal Revenue Code qualified plan status and comply with GASB requirements

It is difficult to answer the specific question about the distinct impact of each element of the Governor's reform proposal on the actuarial accrued liability 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, further, may lead someone to an incorrect or incomplete conclusion as to the true or relative value of that reform element.

While we cannot provide the impact of each element of the reform proposal on the liabilities of the system, 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 automatic COLA increases in the future 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
- Decreasing the benefit formula for future service to n/65 (all employees)
- Increasing employee contributions to 8.5% (all employees)
- Increasing retirement to age 65 (employees < 25)
- Increasing final avg. earnings period to 5 yrs and 3 yrs (employees < 25)

As stated at the beginning of this response, the reforms are projected to result in significant reductions in the unfunded liabilities in the aggregate by 2041when compared to the current benefit levels. The results are muted in the early years by reducing the systems' assumed rate of return from 8.25% to 7.5% and by the 7 year phase-in of state contributions which does not result in a full contribution to the systems until FY 2018. Therefore, it takes roughly 10 years until one begins to see incremental improvement in the funded ratio and reduction in the unfunded liability. To be sure though, from day one the Governor's plan sets a path to return the systems to a more secure future for all of our employees and retirees.

Question: The State Investment Council has voted to increase the portion of the State pension funds portfolio that may be placed in alternative investments (hedge funds, private equity firms, real estate, and commodities) from 28 percent to 38 percent. Please indicate to what extent the Council discloses investment contracts with hedge funds and private equity firms. Are they disclosed in their entirety? Does the public have full and complete access to all of the provisions of the contracts through the Open Public Records Act? If elements of the contracts are not subject to public review, please explain the grounds for the non-disclosure.

Answer: The Division of Investment invests in private equity investments and hedge funds through participation in alternative investment vehicles. Generally, these investment vehicles take the form of limited partnerships. When the Division determines to become a limited partner in an alternative investment vehicle, it presents the material terms of the investment to the State Investment Council in open session. Written material presented to the Council is posted on the Division's website. Documents evidencing the State's subscription to the fund is disclosed upon request under the Open Public Records Act, with necessary redactions for sensitive financial information (e.g., bank account numbers). Documents setting forth the governing structure of the partnerships and their investment parameters (i.e., partnership agreements) and related documents addressing issues specific to the State as an investor (i.e., side letters) are exempt from disclosure under the Open Public Records Act, because the documents are trade secrets, because they contain proprietary commercial and financial information, and because disclosure of the documents would provide a competitive advantage to other investors and funds. The Appellate Division recently addressed this issue in CWA v. Rousseau, 417 N.J. Super. 341 (2010), and concluded that the Division acted properly in withholding the partnership agreements and side letters from requestors under OPRA and the common law.