

## RESEARCH SUMMARY

## Connecticut's Public Employee Pension Funds: Why They May Not Deliver and How They Can Be Fixed

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Connecticut's public employee pension plans are among the most poorly funded in the nation. With few new financial resources at its disposal, Connecticut, like other states, has made increasingly risky investments in hopes of garnering higher returns and reducing the need for increased taxpayer contributions. Regrettably, most government disclosures and reports on pensions ignore this investment risk.

In "An Analysis of Connecticut's Public Employee Retirement Plans," Andrew G. Biggs and Tracy C. Miller examine the range of possible investment return outcomes for Connecticut's public employee retirement plans. They then use a computer simulation model to illustrate how more realistic rates of return, which reflect the status of pensions as safe investments, would require even greater annual employer contributions to restore Connecticut public pensions to full funding.

### GETTING REAL ABOUT PENSIONS

Currently, Connecticut's public employee pension plans assume a 6.9 percent annual rate of return. But because these plans invest in risky portfolios, there is a substantial probability that rates of return will be lower than 6.9 percent. If Connecticut's pension investments were to return 4.1 percent annually, the state would need to increase pension contributions by about 44 percent to achieve full funding over the plans' scheduled time frame of between 20 and 25 years.

Restoring Connecticut's pensions to full funding will likely cost much more than the 13 percent of the state budget that Connecticut has recently been spending. Increasing contributions to pensions will necessarily require the state to make difficult tradeoffs, including cuts to other state and local government priorities such as education, healthcare, and transportation.

### THREE WAYS THAT CONNECTICUT CAN ADDRESS THE PROBLEM

- 1) The state intends pension benefits to be as safe and certain as payments offered to bondholders. Even though the pension funds are invested in risky assets, their liabilities should be valued using a discount rate equal to bond interest rates.
- 2) Connecticut's pensions should provide greater disclosure of how risky pension investments could affect plan funding and taxpayer costs. Risky investments such as stocks remain risky even over the long term, but pension financial disclosures ignore this risk.
- 3) The state of Connecticut should either commit to providing more funding each year or find a way to reform pensions so that taxpayers share with employees the risks of offsetting lower-than-expected investment returns in the future.