**TO: PCS, DLG**

**FROM: JLS**

**DATE: 3/1/2017**

**RE: STATE-REQUESTED MUNICIPAL CONTRIBUTIONS TO TEACHERS’ RETIREMENT FUND**

**MEMORANDUM**

**Question Presented**

 Whether the State of Connecticut (the “State”) may require municipalities to contribute to the State’s Teacher Retirement Fund (the “STR Fund”) through the State’s budgetary process.

**Brief Answer**

 Absent an authorizing statute requiring municipalities to contribute to the STR Fund, State law does not allow for any mandatory municipal contribution to the STR Fund.

**Background**

 In a Press Release dated February 3, 2017, Governor Dannel P. Malloy announced a State budget proposal requiring that municipalities contribute one-third of the employer share of the actuarial cost of the STR Fund.[[1]](#footnote-1) This proposal is a departure from the historical role of the State as the primary contributor to the STR Fund, along with educators themselves. In a Fact Sheet published in conjunction with the press release, entitled “Asking Towns to Partner in Supporting and Fully Funding the Teachers’ Retirement System,” the office of the Governor states that the proposal is driven by the need “[t]o build a better partnership between the state and local governments in making good on promises made to educators.”[[2]](#footnote-2) Various municipal clients have asked us to assess the State’s authority to require municipal contribution to the STR Fund.

**Analysis**

**I.** **The Sources of Funding for the STR Fund are Dictated by Statute, and the Statute does not Provide for Municipal Contributions to the STR Fund.**

The Connecticut General Statutes set forth the specific sources of funding for the STR Fund, and the statutes do not allow for municipal contributions as a source of funding. The State of Connecticut has administered the STR Fund since at least 1939.[[3]](#footnote-3) The STR Fund and the State’s role in administering the fund are governed by Chapter 167a of the Connecticut General Statutes (the “Statute”). The STR Fund provides “retirement and other benefits for teachers, their survivors, and beneficiaries.”[[4]](#footnote-4) The Statute requires that the STR Fund be funded on an actuarial basis, and the State retirement board is required on an annual basis to certify the amount needed to maintain the STR fund.[[5]](#footnote-5) Section 10-183r discusses the means by which the STR Fund must be funded, stating that:

[t]he cost of all benefits payable from the system shall be paid out of the retirement fund which *shall consist of contributions paid by members, appropriations by the General Assembly based upon certifications and recommendations submitted by the board, the proceeds of bonds held by the system under section 10-183m, the proceeds of bonds issued pursuant to section 10-183qq and earnings of the system.* (emphasis added).[[6]](#footnote-6)

 Thus, Section 10-183 limits the sources of funding for the STR Fund to (i) contributions by members of the education system, (ii) appropriations by the State General Assembly based on recommendations by the Teachers’ Retirement Board regarding the valuation of the fund, (iii) the proceeds of bonds, or (iv) earnings from STR Fund investments. In addition to setting forth the sources of funding for the STR Fund, the duties of the State in administering the STR Fund, and the process by which fund requirements are calculated, the Statute makes clear that the benefits accrued by members of the education system are contractual in nature, “and no public or special act of the General Assembly shall diminish such benefit.”[[7]](#footnote-7)

 The Governor’s proposal likely violates Section 10-183r of the STR Fund statutes. The Statute sets forth the specific sources of funding for the STR Fund, none of which includes municipal contributions. Any budgetary requests purporting to require municipal participation in the funding of the STR fund is outside the scope of the statute.

**II.** **In the Event that the State’s Obligations Pursuant to the STR Fund are Unfunded, the Statute Provides Specific Protocols and Procedures to Address Unfunded Liabilities, which Protocols and Procedures do not Include Municipal Contributions to the STR Fund.**

 If the State cannot meet its STR Fund obligations, the Statute requires the State to follow specific procedures in addressing its unfunded liabilities. It has been widely known for some time that a portion of the Connecticut teacher pension fund is presently unfunded. In 2014, the Board of Directors of the Connecticut State Teachers’ Retirement System commissioned an independent study from Cavanaugh Macdonald Consulting, LLC, to examine the valuation and liabilities of the STR Fund.[[8]](#footnote-8) The study, titled “Connecticut State Teachers’ Retirement System Actuarial Valuation,” compared the accrued liabilities of the STR Fund to the fund’s assets. The study concluded that the accrued liabilities of the fund exceeded the fund’s asset by over $10 billion.[[9]](#footnote-9) Similarly, other studies indicate that Connecticut’s unfunded pension costs per-teacher exceed $14,000.00.[[10]](#footnote-10) These costs are expected to rise over the next 18 years if the State continues with its current pension plan for educators.[[11]](#footnote-11) Each of these indicators highlight that a portion of the STR Fund remains unfunded. In the event that any portion of the STR Fund is unfunded, the Statute provides a specific mechanism to replenish the fund. Under Section 10-183qq, the State Bond Commission is authorized to issue Pension Obligation Bonds in a total amount not to exceed $2 billion for the purposes of addressing any unfunded liability of the STR Fund. The Statute specifically states that the proceeds of the sale of these bonds must be used to reduce the unfunded liability of the STR Fund.

 The Governor’s proposal circumvents the mechanisms set forth in the Statute to address unfunded liabilities of the STR Fund. Because the Statute provides for a specific process by which the State can address the unfunded liabilities of the STR Fund, the State should address any unfunded liabilities of the STR Fund through this process.

**III.** **Altering the State’s Required Contributions to the STR Fund May Violate Covenants Made by the State Pursuant to Pension Obligation Bonds Issued in 2008 to Address Unfunded Liabilities of the STR Fund.**

The Governor’s proposal may violate certain covenants made by the State in bonds previously- issued to address the STR Fund’s unfunded liabilities. As previously discussed, the State is authorized to issue Pension Obligation Bonds in order to address any unfunded liabilities of the STR Fund. In 2008, the State issued bonds in the amount of $2 billion to cover unfunded obligations of the STR Fund, payable over a 25 year period.[[12]](#footnote-12) These bonds included certain covenants made by the State as the bond-issuer, including the following:

[t]he State of Connecticut does hereby pledge to and agree with the holders of any bonds issued […] that, as long as the actuarial evaluation for each biennium, as required by this section, and the certification of the annual contribution amounts, as required by this section, are completed in the manner and by the dates required […] *no public or special act of the General Assembly shall diminish such required contribution until such bonds, together with the interest thereon, are fully met and discharged*.[[13]](#footnote-13) (emphasis added).

 The aforementioned covenant obligates the State to make certain contributions to the STR Fund and prohibits the State from reducing its own contributions to the fund. In a news publication discussing the ramifications of reducing state contributions to the STR Fund, State Treasurer Denise Nappier suggests that altering contributions to the STR Fund “would be a (legal) problem.”[[14]](#footnote-14) The Treasurer’s general counsel, Catherine LeMarr, reiterated Treasurer Nappier’s concerns regarding the legality of altering contributions to the STR Fund, and questioned whether paying benefits to retired workers out of the state budget (rather than the pension fund) would require IRS approval.[[15]](#footnote-15)

 The Governor’s proposal may violate certain covenants made by the State in the 2008 bond issuance. The bond covenants include a pledge by the state to make annual contributions to the STR Fund, and the covenants prohibit the State from diminishing its own contributions to the STR Fund. The Governor’s proposal shifts a portion of contributions to the STR Fund from the State to municipalities. This shift diminishes the State’s required contributions to the STR Fund, and may violate the bond covenants as suggested by the office of the Connecticut Treasurer.

**Conclusion**

 The Governor likely cannot require municipalities to contribute to the STR Fund through the state budgeting process. Requiring municipalities to contribute to the STR Fund violates state statutes that specifically address (i) the allowable sources of funding for the STR Fund, and (ii) the mechanisms by which the State should address any unfunded liabilities of the STR Fund. In addition to the statutory restrictions faced by the Governor, his proposal may also violate covenants made by the State in 2008 pursuant to the issuance of Pension Obligation Bonds.

1. “Gov. Mally Asks Towns to Partner in Supporting and Fully Funding the Teachers’ Retirement System,” Office of State of Connecticut Governor Dannel P. Malloy, February 3, 2017 (http://portal.ct.gov/Office-of-the-Governor/Press-Room/Press-Releases/2017/02-2017/Gov-Malloy-Asks-Towns-to-Partner-in-Supporting-and-Fully-Funding-the-Teachers-Retirement-System) [↑](#footnote-ref-1)
2. “Asking Towns to Partner in Supporting and Fully Funding the Teachers’ Retirement System,” Fact Sheet, Office of State of Connecticut Governor Dannel P. Malloy, February 3, 2017. [↑](#footnote-ref-2)
3. Jean-Pierre Aubry, Alicia H. Munnell, Final Report on Connecticut’s State Employees Retirement System and Teachers’ Retirement System, Center for Retirement Research at Boston College, November, 2015 (http://crr.bc.edu/wp-content/uploads/2015/11/Final-Report-on-CT-SERS-and-TRS\_November-2015.pdf), 30. [↑](#footnote-ref-3)
4. C.G.S.A. 10-183c [↑](#footnote-ref-4)
5. C.G.S.A. 10-183z. [↑](#footnote-ref-5)
6. C.G.S.A. 10-183r(2). [↑](#footnote-ref-6)
7. C.G.S.A. Sec 10-183c [↑](#footnote-ref-7)
8. Cavanaugh MacDonald Consulting, LLC, Connecticut State Teachers’ Retirement System Actuarial Valuation as of June 30, 2014, October 29, 2014 (https://www.documentcloud.org/documents/1350415-teachers-pension-report.html) [↑](#footnote-ref-8)
9. Id., at 8. [↑](#footnote-ref-9)
10. Jacqueline Rabe Thomas, Report: CT 4th Worst in Unfunded Pension Liabilities per Teacher. CT Mirror, May 16, 2016 (http://ctmirror.org/2016/05/16/report-ct-4th-worst-in-unfunded-pension-liabilities-per-teacher/) [↑](#footnote-ref-10)
11. Jean-Pierre Aubry, Alicia H. Munnell, Final Report on Connecticut’s State Employees Retirement System and Teachers’ Retirement System, Center for Retirement Research at Boston College, November, 2015 (http://crr.bc.edu/wp-content/uploads/2015/11/Final-Report-on-CT-SERS-and-TRS\_November-2015.pdf), 53. [↑](#footnote-ref-11)
12. Keith M. Phaneuf, CT Faces Legal Roadblock to Easing Rising Teacher Pension Costs, CT Mirror, June 20, 2016 (http://ctmirror.org/2016/06/20/ct-faces-legal-roadblock-to-easing-rising-teacher-pension-costs/) [↑](#footnote-ref-12)
13. 2008 Pension Obligation Bond – State of Connecticut (https://assets.documentcloud.org/documents/2511193/connecticut-pob-covenant-for-teachers-retirement.pdf) [↑](#footnote-ref-13)
14. Jacqueline Rabe Thomas and Keith M. Phanuef, Treasurer Raises More Concerns About Malloy’s Plan for Pensions, CT Mirror, November 10, 2015 (http://ctmirror.org/2015/11/10/treasurer-raises-more-concerns-about-malloys-plan-for-pensions/) [↑](#footnote-ref-14)
15. Id. [↑](#footnote-ref-15)