
Committee Meeting

of

SENATE STATE MANAGEMENT, INVESTMENTS AND FINANCIAL INSTITUTIONS COMMITTEE

"Testimony concerning the Governor's public employee
pension and health benefits financing reform proposals"

LOCATION: Committee Room 12
Legislative Office Building
Trenton, New Jersey

DATE: May 19, 1994
10:00 a.m.

MEMBERS OF COMMITTEE PRESENT:

Senator Peter Inverso, Chairman
Senator Dick LaRossa, Vice-Chairman
Senator John "Jack" Casey
Senator Bernard F. Kenny, Jr.



ALSO PRESENT:

Joseph P. Capalbo
Office of Legislative Services
Aide, Senate State Management,
Investments and Financial
Institutions Committee

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PETER INVERSO
Chairman

DICK LAROSSA
Vice-Chairman

JOHN P. SCOTT
JOHN "JACK" CASEY
BERNARD F. KENNY, JR.

New Jersey State Legislature
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C O M M I T T E E N O T I C E

TO: MEMBERS OF THE SENATE STATE MANAGEMENT,
INVESTMENTS & FINANCIAL INSTITUTIONS COMMITTEE

FROM: SENATOR PETER INVERSO, CHAIRMAN

SUBJECT: **COMMITTEE MEETING - May 19, 1994**

The public may address comments and questions to Joseph P. Capalbo, Committee Aide, or make bill status and scheduling inquiries to Lynn Rogers, secretary, at (609) 292-9106.

The Senate State Management, Investments & Financial Institutions Committee will meet on **Thursday, May 19, 1994 at 10:00 A.M. in Committee Room 12, Legislative Office Building, Trenton, New Jersey.**

The committee will hear testimony from administration officials, members of the public and interested organizations concerning the Governor's public employee pension and health benefits financing reform proposals.

Issued 05/13/94

Assistive listening devices available upon 24 hours prior notice
to the committee aide listed above

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SENATOR PETER INVERSO (Chairman): I would like to call the meeting to order, please. Thank you.

The purpose of today's meeting is to hear testimony from administration officials, members of the public, and other interested parties concerning the Governor's proposal to restructure, revamp, reform the public employee pension system and health benefit programs.

The first order of business will be to hear from the administration, which will provide us with their overview of the proposals. The Treasurer appeared before a Joint Budget Committee yesterday, and the pension proposals were the subject of much questioning and answering, and discussion. For those of us who serve on both Committees some of this may be perhaps a rehash, but what won't be a rehash is the opportunity for the other concerned parties to come forward to offer their insight, input, and critique of the proposal. Hopefully, this will be the beginning of an opportunity to have a complete airing of all the issues, and allow this Committee and the Legislature, as a whole, to reach a determination as to the efficacy and appropriateness of the proposal.

With that, is there any member of the Committee who wishes to make an opening statement?

SENATOR KENNY: Only that we who were on the Committee yesterday really do not consider today a "rehash." I do not mean to poke fun at that word. We deferred our concerns until today.

SENATOR INVERSO: And I did, also, yesterday. As you know, I didn't raise any questions, but there were some members, I think, on the Assembly side, who had an opportunity to hear input with regard to the proposal, and they raised some questions as a result of having had that previous opportunity. As you said, we kind of restrained ourselves yesterday, awaiting today's opportunity.

So thank you, Senator Kenny, for that correction.

SENATOR KENNY: Okay.

SENATOR CASEY: Does that mean-- We restrained yesterday. Can we let our hair down today? (no response)

SENATOR INVERSO: My day is complete. Now, we can go forward.

Treasurer, thank you. Will you please just introduce those who are with you, and then proceed?

TREASURER BRIAN W. CLYMER: Yes.

Good morning, Senator Inverso, and members of the Committee. Thank you for allowing me to appear today to discuss the proposed changes to the State's pension systems that are included in the Governor's budget recommendations.

Joining me today are Marge McMahon, Director of the Division of Pensions and Benefits, to my immediate left; to my immediate right, from your perspective, Bob Baus, to my far left, a principal and consulting actuary with Buck Consultants; and Bill Reimert, on my immediate right, a principal and consulting actuary with Milliman & Robertson, Inc. Mr. Baus is an independent actuary whose firm provides advice to the Public Employees' Retirement System and the Teachers' Pension and Annuity Fund. Mr. Reimert is an independent actuary whose firm provides advice to the Judicial Retirement System, the State Police Retirement System, and the Police and Firemen's Retirement System.

Director McMahon, Mr. Baus, and Mr. Reimert all share a keen understanding of the proposed changes that are included in this budget recommendation. With the indulgence of the Chair, I would like to offer their expertise to the Committee during this meeting today.

Before I discuss the changes we are proposing, I would first like to discuss the current status of the State's pension systems. The conditions of the pension systems, in both the public and the private sectors, are generally determined by looking at the systems' funding level. The funding level, at a glance, reveals the level of assets that, if the plan were

suddenly to be terminated, could be used to satisfy the pension liability that has accrued to date.

Our asset level is impressive. Our pension funds, in total, combine to form an asset portfolio of nearly \$36 billion. If you look at my printed comments, it says "million." We are a little above that. These assets are managed by the Division of Investments, directed by Roland Machold. Over the past five years, those assets have earned a rate of return in excess of 10 percent. Last year, those assets earned more than 12 percent.

To facilitate the comparison between and among pension systems, two computing methods are in common use: the Projected Benefit Obligation, or PBO method, and the Accumulated Benefit Obligation, or ABO method. They are displayed for you on the chart to my immediate right here.

The primary difference between the two methods is that the PBO method assumes annual pay increases for every employee in the pension system, for all future years of an employee's service; that is, every employee -- it makes this assumption -- would receive a 6 percent increase each and every year of their working life. According to both of these measures, New Jersey's pension systems are exceptionally well-funded.

An analysis of the pension systems using the ABO method shows a funding level that ranges from 104.8 -- almost 105 percent in the teachers' pension -- to nearly 130 percent funding in the local portion of the PERS system. By comparison, the national averages using the ABO method for similar systems are 89 percent for the teachers' pensions, and 108 percent for public employee systems.

Our analysis using the PBO method was very conservative, and assumed that this and every future Legislature would grant annual raises to each and every State employee, and that the public employee workforce would remain at its current level, or grow.

Mr. Baus and Mr. Reimert can better explain the mechanics of the PBO and the ABO processes, but I do think it is important for everyone here today to understand the magnitude of the future raises that were assumed in the PBO calculation. To measure the effect of large pay increases over an extended period, our actuaries assumed -- as I mentioned earlier -- that public employees, across-the-board, would receive annual pay raises of 6 percent every year of their careers.

I certainly do not believe that Governor Whitman and her successors would authorize such annual raises, nor do I believe that this and future Legislatures would fund such increases. Despite this assumption, the analysis still found our funding levels above the national average, ranging from approximately 84 percent for the TPAF to 96.3 percent for the local portion of the PERS system. The national average for similar systems is 79 percent for teachers' pension systems, and 96 percent for local public employee systems.

The actual funding level of our pension systems probably falls somewhere between the PBO level and the ABO level. In the same way that workforce-wide 6 percent raises are unlikely, it is equally unrealistic to assume that there will be no raises at all for our employees.

When I appeared before the Senate and Assembly Appropriations Committees, I discussed the need for all public managers to control their cost drivers. As early as the first days of the transition period, the Governor-elect and her advisers were assessing the primary cost drivers of the State budget. Chief among them was pension spending. State pension contributions are growing at an alarming rate.

If we make absolutely no changes to the current funding system for pensions and benefits, the State government's annual contribution will grow from \$603 million in

1994 to \$1.36 billion in 1998. Over four years, absent any changes, the tab for pensions will more than double. The situation for local governments is slightly better, but still deeply troubling.

This year, local governments will contribute \$334 million to public pension funds. Under the current funding system, by 1998, those contributions will escalate by nearly 60 percent. Under the current funding system, the annual local government contribution to public employee pension systems will exceed a half a billion dollars in 1998.

Without making changes today, this inflationary spiral will continue to consume public resources at an extraordinary rate. Without making changes today, pension contributions will consume an ever larger portion of State and local budgets in the years to come.

Contributions to the public employee pension funds currently account for 4 percent of the State's annual spending. By 1998, if there is no increase in State spending, these contributions will account for nine cents out of every dollar spent in the State budget.

Spread evenly among all taxpayers, this \$1.3 billion annual pension bill translates to a \$350-per-every-household tax. This levy is an annual and escalating tax payment that enhances no services, that repairs no highways, educates no children, puts no police on the beat, and creates no jobs.

The policy implications of continuing this spending trend are clear. Failing to make changes today would mean a future in which State taxes would increase, State aid would be reduced, and State programs curtailed.

Our options were to allow this spending trend to continue and face its consequences in future years, or to confront and correct it. We chose to address the problem head-on. We chose to address this spending trend now, rather than wait. We assembled the finest actuaries available, and

instructed them to review our system of pension funding and make recommendations about changing that system according to several guiding principles:

- * That not a penny's worth of the more than \$30 billion worth of assets -- actually \$36 billion worth of assets -- in the State's pension funds should be touched.

- * That the benefits provided to our retirees or their survivors should not be altered.

- * That the actuarial assumptions which determine our contribution levels should be reflective of current economic conditions, budget trends, and policy changes.

- * That one-time savings should be avoided.

- * That any change should be in accordance with accepted actuarial practice.

The recommendations that resulted from their review -- recommendations that meet each and every one of the principles I previously discussed -- are incorporated in the Governor's proposed budget. Those changes are:

- * To replace the Entry Age Funding Method with the Projected Unit Credit Method.

- * To amortize the unfunded liability of the systems over a 40-year period.

- * To eliminate the prefunding of post-retirement health benefits.

- * To roll back the phase-in period for recognition of COLAs.

- * To eliminate the 2 percent subsidy on pension contributions up to the Social Security wage limit.

- * To extend the phase-in period for recognition of the latest TPAF experience changes from two years to five years.

I will briefly discuss these changes. Director McMahan and our actuaries will discuss each of them in greater detail, if you would like.

The shift from the Entry Age Funding Method to the Projected Unit Credit Method was proposed because it is more responsive to changes in the size of the State's workforce.

The shift from the 30-year amortization of the systems' unfunded liability to a 40-year period was selected because it is reasonable based on common practice, because of the economic results of the 1989 studies of the systems prepared by two nationally recognized actuarial firms and the precedent set in ERISA.

The move away from the prefunding of post-retirement health benefits to a pay-as-you-go method was based on our recent experience in the actual cost of health benefits and developments on the Federal level with regard to health care.

Medical cost trends have decreased dramatically from a level in the mid-to-high teens to a level which, in general, is below 6 percent. In the case of the State government's experience, the latest data indicate a substantial tempering of inflation in the cost of medical benefits. I call your attention to the chart in front of you to your left indicating Fiscal Year 1994 on top, compared with Fiscal Year 1994 below that. You see it arrayed for pre-'65 and post-'65, including Medicare. If you compare the totals in the right-hand columns for single retirees, retiree with spouse, and retiree with family, you will notice the decrease from 1994 to 1995.

This lower trend rate raises serious questions about equity among current and future taxpayers.

A 10-year projection of health benefit funding at the current rate compared with a similar projection of anticipated health benefit costs indicates that by the year 2004, over a billion tax dollars would be unnecessarily bankrolled every single year. Each year, the State would build a billion-dollar surplus for no anticipated purpose. I again call your attention to the two charts: the one on the left representing the Public Employee Retirement System, and the one on the right

representing the teachers' system. The solid line indicates the current trend, with the dotted line representing the revised trend to pay as you go. As you can see -- as I just indicated -- within a few years, the combination dealt us between the two plans creates a billion dollars of additional moneys put away.

Taking a billion dollars out of the private economy is both unwise and unfair. A billion dollars saved, spent, or invested by the private sector creates jobs, opportunity, and growth. A billion dollars of taxes demanded by the government, with no purpose, simply creates an attractive target for a real pension grab; the kind of pension grab where the State helps itself to our pension assets; the kind of pension grab where, as our labor leaders aptly describe it, the State puts its hands on the employees' money.

Governor Whitman has no intention, I have no intention, and I am sure the members of the Legislature have no intention of taking any of the pension funds. And, speaking for the Governor and her administration, we have no intention to overfund the systems and create an ever-expanding temptation for a pension raid in the future.

This proposed change is fair and honest. It will result in contribution levels that reflect actual need. It will allow the highest and best use of State resources, and at the same time, will provide adequate funding for health benefits. Because this change results in substantially reduced contributions by State and local units, it allows for tax relief at all levels.

Mr. Chairman, and members of the Committee, this administration is committed to keeping money in the private sector, and this change does just that. This change keeps money in the hands of the people who spend it best -- those who earn it. Rolling back the phase-in for COLAs was selected because this change was viewed as fiscally prudent and responsible. This change will generate savings of \$150 million

to the State and local units in Fiscal Year 1995, and equivalent savings in future years. Eliminating the 2 percent pension-member contribution subsidy was selected in fairness to all taxpayers.

The pension-member contribution subsidy dates back to 1955, when Social Security benefits and State pension benefits were integrated. This integration meant that there was an offset in the benefits provided to public employees who were fully contributing to each system.

To adjust for the benefit offset, the State began the pension contribution subsidy. However, in 1966, the integration of the State pension system and the Social Security system was eliminated. The benefit inequity that resulted from the integration of the systems was eliminated as well. In our view, there is no logical basis and no equitable foundation to continue to ask taxpayers to underwrite this subsidy.

* The inequity for which this subsidy provided relief was corrected almost 30 years ago.

* The subsidy results in a unique and unusual treatment for a select group of public employees -- a treatment extended to no private sector employees.

In addition, I think it is important for the Committee members to know that this is a subsidy that is provided to public employees of virtually no other state or jurisdiction in America.

Lastly, I would like to point out that ending this subsidy is not a pay cut. Public employees will not have their base pay reduced in any way by ending this subsidy. In fact, when the 6 percent across-the-board pay raise takes effect in July, every covered employee's current gross pay will be increased by a full 6 percent.

Employees at the local level who have negotiated raises in excess of the State's 6 percent raise, and those who

have negotiated lesser raises, will still see their raises applied to the current base salary they are now receiving.

Finally, the experience recognition period for our mortality tables is modified to ensure that the new table is reflected by the time the 1997 experience review is undertaken.

The benefits of these changes are significant. Most significant is that our contribution rates will be stabilized both in the near term and over the long haul. These changes will reduce the State's reliance on taxpayer earnings in 1998 from \$1.36 billion to \$479 million. These changes will result in a \$900 million savings in that year alone. These changes will stabilize local contributions, as well. In 1998, these changes will generate over \$200 million in savings; \$200 million that I believe we all hope will be passed on directly to local property taxpayers.

If you look at the boards here under both the Anticipated PBO method and the ABO method, we are comparing the level -- the percent funded of the plans to show that even under the proposed change -- under the solid line -- that there will continue to be an increase in pension assets.

Not only will these changes result in savings for the current and immediate budgets, but they will produce substantial savings in future budgets, as well. These changes were made, tax equity achieved, and savings provided without any change in benefits, and without skimming a single cent from the assets of the State's pension funds.

Senator Inverso, I want to again thank you for inviting me here to discuss these changes with you. Pensions are a critical part of State budgeting. A thorough understanding of the pension system and our funding of that system is crucial to responsible fiscal policy.

I would now like to turn to Director McMahan, Mr. Baus, and Mr. Reimert for some brief remarks before we answer any questions you or your Committee may have.

M A R G A R E T M. M C M A H O N: Good morning, Mr. Chairman, and members of the Committee. I am very happy to be here this morning, and this is certainly not my first appearance to talk about pension policy.

As we all know, public pensions cost millions of dollars in State revenues every year. For that reason, it is appropriate that pension policy be regularly and carefully reviewed to ensure that the benefits to which public employees are entitled are adequately funded and safeguarded, and that the State's taxpayers pay only the amount necessary to provide and safeguard these benefits.

The Treasurer has given an overview of what the Governor's pension proposal is all about. So I am going to end my comments -- make them rather short. I will be available for questions. I am going to turn it over to Bob Baus right now, who is the actuary for the teachers and the public employees. I don't know if Bob has any comments, or whether he will just be available to answer questions.

R O B E R T D. B A U S: Good morning, Mr. Chairman, and members of the Committee.

I just want to touch on one point, I think, with regard to the proposals. We have, obviously, done a fair amount of analysis of what the implications are. I think the most important thing that needs to be considered is the security of the benefits. I think, from our standpoint, at least from mine, with regard to the teachers' fund and the employees' fund-- That has been of paramount importance as we have gone through the analysis process. As a result of that, I just want to emphasize one point that the Treasurer made.

The projections we have done on the new funding policy -- and I might say that the policy being recommended is certainly one that is generally accepted in the actuarial industry-- The projections we have done for both of the systems indicate that the funding under this policy will be

adequate to fully secure the benefits over the next 30 to 40 years. That, I believe, is certainly acceptable by anyone's measure. What that means is that the PBO projections that we are showing over here (indicates chart), whether I use the assumptions we are using now, or even on an alternative set of assumptions that are more conservative than what we are using now-- We have established that the amount that is being funded into the system each year is sufficient to reach the 100 percent ratio. I think that is the key goal of any pension funding policy.

MS. McMAHON: Do you have any comments, Bill?

W I L L I A M A. R E I M E R T: Just very briefly. I am Bill Reimert. I serve as actuary to the Police and Firemen's, the State Police, and the judicial retirement systems. I was glad to hear that Bob wanted to highlight the fact that benefit security is clearly of prime importance here. I was glad that he already picked up on that.

Maybe just to elaborate very briefly on the other point he made, at least with respect to the three systems that I serve, three of the specific reform proposals would affect them: a change to stop prefunding retiree health; a change to the unit credit method in the 40-year period-- I believe, as part of your handout, you have a letter from us where we discussed our reasons for reaching the conclusion that we state at the end. I would just like to read it:

"We believe that each of the above three proposed reforms" -- just the three that affect the systems I serve -- "are reasonable, since the effect of adopting these proposed reforms would be to reduce the level of contributions to the retirement systems in the future. The emerging actuarial experience should be carefully monitored, so that contributions can be adjusted to reflect any unfavorable deviations and actual experience from that assumed."

I wanted to highlight both the fact that these proposals are reasonable, and also they just reinforce the ongoing need -- things that have been done in the past and, of course, will have to continue to be done in the future to monitor the funding of these systems to make sure that the assets are there to pay the benefits when they become due.

Thank you.

SENATOR INVERSO: Thank you.

Anything else?

TREASURER CLYMER: Mr. Chairman, we are available for your questions.

SENATOR INVERSO: Well, thank you. I'm sure there are going to be many questions from the Committee.

I would just like to start by saying: I understand, from an actuarial perspective, that there are, perhaps, a number of appropriate approaches -- appropriate methodologies. I believe there is no right one or no wrong one. I think there are preferred ones. I think they are preferred based upon what the objectives are. What I glean from all I have read and all I have heard, is that in the context of avoiding what is projected here to be a tremendous overfunding of the system, the actuarial changes that are considered are preferred with the objective of not overfunding a system that will remain healthy and sound, with the benefits intact.

Is that basically a fair characterization of where we're going?

TREASURER CLYMER: I think that is a fair characterization.

SENATOR INVERSO: But in doing that, I think it is important for us, too, to look, obviously, long term as actuaries look long term. I know actuaries kind of ignore aberrations on a near-term basis to take a look at where we should be going forward and how we should get there.

One of the most controversial aspects of the proposal, I mean, in addition to what I call the "bread and butter" proposal, that is, the 2 percent of pension subsidy reduction, is the elimination of the pay-as-you-go aspect for health benefits. I read in both of the accompanying transmittal letters to the actuarial report, both from Buck Consultants and from Milliman & Robertson, Inc., that there is a cautionary note with regard to the conditions that exist; that we would have to evaluate those conditions, certainly, in the near term. We are talking, perhaps with the three-year review period, that perhaps we have to kind of take a step back and assess where we are as a result of going on the pay-as-you-go.

From an actuarial standpoint, you are comfortable with doing that, even though, as I say, you tend to look long term in your perspective when you are doing actuarial assumptions.

MR. BAUS: Mr. Chairman, if I may respond, I think the issue of what is going on in Washington is key to this right now. I mean, the Treasurer has mentioned what is going on here in the State with regard to trend rates and so forth. I think the big unknown is what is going to come out of the health care reform, and to take a couple of years -- to take a step back for a couple of years going to pay-as-you-go until we see how that settles down, and really what happens with regard to trend rates once we know what is going to come out of Washington.

I am comfortable with that. I think it is important -- and you have made the point -- that none of these proposals and, in fact, the current policy, are not cast in stone. It is reviewed every three years with the trustee boards. Certainly, this would be one of the items that would be reviewed each time we do that kind of a review.

MR. REIMERT: Just to elaborate on that briefly: Two of the three systems I work on are affected by this; police and firemen are not. But for the two that are affected, those systems are in a somewhat different situation than PERS and

TPAF, in that up to this point, those systems have always financed retiree health insurance on a pay-as-you-go basis. So, at least from my perspective, it is a somewhat different situation, but I think it helps to clarify the issue of, if up through Fiscal Year '94 the State had never prefunded the retiree medical, given the circumstances, and most especially in Washington with possible Federal reform of the way health insurance is financed in our country, why is it urgent that the State start to advance fund those benefits under both the State Police and the judicial system in Fiscal Year '95?

I have difficulty coming up with some reason why it is clearly urgent that you do, now, commence that process in Fiscal Year '95. I was glad you picked up on the need to look at things based on current conditions over time. I don't know what will happen in Washington. I don't think any of us here pretend that we do. But, to me, it is sensible and reasonable to let the dust settle, see what Washington is going to do, and perhaps in a year or two we will conclude that maybe then it is appropriate to go back to that method. On the other hand, it is easy to see how some of the proposals that are on the table in Washington would probably result in not needing to take that step a few years down the road.

SENATOR INVERSO: Good. Just to play devil's advocate for a bit, one could alternatively argue that if we have, indeed, seen what is a welcome reduction in the rate of increase in the cost of benefits, perhaps factoring that element into the equation, as opposed to reverting to a system that goes from prefunding to pay-as-you-go, would be an appropriate approach. Could you respond to that, as to whether, from an actuarial standpoint, that would have been the preferred way to go?

MR. REIMERT: Just speaking for the two systems I work on, I don't think I would say it is preferred, but certainly I would say that is another reasonable way to go, to decide -- to

recognize the significant reduction in health cost trends, not to start prefunding based on the high trends that we have been using as recently -- roughly as a year ago, when we did the valuations. I mean, I certainly would not argue that that is an inappropriate or wrong step to take. I do not mean to imply that at all.

SENATOR INVERSO: No, I understand.

MR. REIMERT: I think both of them would be reasonable approaches.

SENATOR INVERSO: Ms. McMahon, you wanted to respond?

MS. McMAHON: Before I turn it over to Bob, Mr. Chairman, I would just like to make one comment: Through all of our discussions on pension reform, the question has been asked many times about what other states do. The Treasurer has pointed out, through the charts, how well-funded we are compared to other states. New Jersey is in very good shape. The question has come up, too, what do other states do about prefunding post-retirement medical? The answer is, very, very few states do prefunding at all. So I think that is important to know.

Okay, here's Bob.

MR. BAUS: I think my response would probably be similar to Bill's. As you have stated, Mr. Chairman, with regard to actuarial processes, there is always a range of what makes sense and what is reasonable. In point of fact, we actually did look at what you have suggested, just modifying current trend rates and perhaps using projected unit credit to fund them. So this was also on the minds of the people who were formulating the policy. That is certainly acceptable. That is certainly a middle-of-the-road step, compared to where we are right now. But I think that is within a range where pay-as-you-go funding is on one end, and the current situation is on the other.

SENATOR INVERSO: Where, going forward, do the lines cross? Do you have projections in terms of the cash flow? I can't see the chart too well. Does that go to 1996?

TREASURER CLYMER: That goes to the year 2006. As you can see, they are substantially apart.

MR. BAUS: Pension, yes.

TREASURER CLYMER: This is not, this is the pay-as-you-go. This is the health.

SENATOR INVERSO: I know that. But the chart you had earlier--

TREASURER CLYMER: That is the combined pension plans together. There is an out year crossover--

MR. BAUS: Yes, 2017. Well, let me say we have done the analysis on the two big systems, and 2017 -- it is either 2017 or 2018 -- is where the pension costs' crossover takes place.

SENATOR INVERSO: Okay. Now, from an actuarial perspective, that is sufficiently far out there that there are so many other environmental changes that could occur to make that convergence another point in time?

MR. BAUS: Well, yes. There's--

SENATOR INVERSO: It could either be sooner, or it could be later, correct?

MR. BAUS: We have actually done a little bit of a sensitivity analysis on that. It really doesn't make a big difference. For example, inflation is a big unknown, and depending on whether inflation is down or up, you get a different view, because it affects the financing to such a degree. It does not do much in the way of shifting that time period.

The other interesting thing that has come out of the projections, is that the crossover point occurring out there-- Actually, we had guessed it would be between 2014 -- which were

the original projections -- and 2020. So it is really right where we thought it was going to be.

The more interesting thing, I think, is that the funded ratio in the long term under projected unit credit drives up to 100 percent and, in fact, depending on inflation, goes over 100 percent. Under the current funding methodology, those ratios go up to 110 percent to 120 percent. The interesting result of that is that not only are there savings today and for the next 15 years or more, but once the crossover takes place, there is not a great, huge spread between the two methods in the out years. They actually tend to stay closer together. Now, understand, that is because the projected unit credit method just drives the funded ratio over 100 percent. That, I think, from an actuarial standpoint, is a reasonable position to be in. I don't know that you would want the PBO to be 120 percent.

SENATOR INVERSO: So you're saying, in those out years beyond -- 2016, is it? -- that spread remains fairly constant, going forward?

MR. BAUS: Yes. It is at a certain point for 5 or 10 -- 10 years, I guess -- and then it actually comes quite close together.

SENATOR INVERSO: Okay; all right. Of course, it is so far out there, I am not sure it is significant. I think, from an actuarial standpoint, you have more of a sense of comfort in the fact that we are not going to see that convergence go so far apart that what we are doing here is really, in fact, loading all our costs significantly.

MR. REIMERT: Mr. Chairman, if I may just briefly add to that, at least with respect to the three systems I work under, a little bit simpler in how that affects them than some of the complications in PERS and TPAF-- Essentially, it really boils down, for those systems, to the difference between a 25- to 30-year mortgage, because police and fire and the other two

systems are roughly in that range, and a 40-year mortgage, in that under current law there is a certain level of contributions that would continue and are expected to remain relatively level as a percentage of payroll, up for roughly 25 to 30 years out into the future. Then, at that point, State and local contributions would drop significantly.

What is happening for the three systems I work on, is that we have a somewhat lower contribution. Instead of then dropping after 25 or 30 years, it continues for roughly another decade to the 40-year point, and then drops down to the level where it would have been going out. So this is not a situation where there is an explosion of costs happening. It is not that kind of a curve-crossing situation. The curves really would cross when the amortization of the mortgage -- the payment of the unfunded liabilities would cease under current law at an earlier point, than under the proposal.

SENATOR INVERSO: That's right. Okay, I understand.

Let me ask a question of Treasurer Clymer about the 2 percent. I think the question was posed yesterday and I think your response was understood, and it set a distinction between whether or not there was a contractual right to this 2 percent. The question is: Is there, in your opinion, a contractual right to the 2 percent pension subsidy that we would have to address relative to this proposal?

TREASURER CLYMER: No.

SENATOR INVERSO: Could you explain why -- why the answer is, "No"? I think you did yesterday, but I just think it is important to have it on the record today.

TREASURER CLYMER: I think it was evidenced by the recent court decision on the challenge to the pension changes several years ago as to whether or not a legislative benefit constituted past practices. I think what came out of that court decision was that it didn't. The Legislature has the ability to change benefits as it sees fit.

SENATOR INVERSO: Okay. Well, in the interest of having the other parties here have an opportunity to come before the Committee-- This Committee meeting will go on until they push us out of this room. I think there is another committee--

MR. CAPALBO (Committee Aide): It is scheduled for 2:00.

SENATOR INVERSO: --meeting at 2:00. I have no problem with that, but what I will do is turn the questioning over to others if they wish to question the administration, so that we can then move on to the other parties that want to testify today.

With that, I will turn to Senator Kenny.

SENATOR KENNY: I would like to defer, for the first question, to Senator Casey, if you don't mind.

SENATOR INVERSO: Okay. Senator LaRossa, you would have been next. Do you have a question?

SENATOR LaROSSA: No, thank you.

SENATOR INVERSO: Senator Casey?

SENATOR KENNY: A junior member goes first?

SENATOR INVERSO: A junior in terms of service on this board, but not in terms of chronological age.

SENATOR CASEY: I guess I have a few questions for both Bob and Bill. In some of your testimony today, both of you used the words you have to "monitor this funding in the future," and so forth. Is there anything in the back of your minds that kind of puts a scare into you that it may not work? The terms both of you used -- and I just wrote them down -- I just wonder if it is-- In other words, it is nice to monitor everything when you do something. I use the word "monitor" a little bit more than I would in the past. It puts a little question mark in my mind. Did I hear it wrong? I just want to make sure that I understood both of you.

MR. REIMERT: Perhaps I will lead off. I think the best answer I can give to that is, "No," which isn't to say that nothing could go wrong. I mean, I don't want to pretend that there is nothing that could possibly go wrong in the future. But I think the basic assumptions we are using are reasonable. I think the actuarial cost method is reasonable. I think everything ties together. I think it is a package which, over time, is probably about as likely to run into surplus as deficiencies. So, on that basis, I do not have any major concerns at all on those.

Bob?

MR. BAUS: I think with regard to the pension proposals, I would echo Bill. I see this new policy as being perfectly acceptable and reasonable. I think we need to monitor it just as we are monitoring the current policy.

I think if there is any potential issue, it is more on the post-retirement medical side. I think that is true under current policy, as well as under what is being recommended. It is purely an issue of what is going to happen in Washington.

SENATOR CASEY: Well, again, I guess if I know what is happening in Washington and hear our Governor's speeches-- She seems to think that the health plan is bad and that everything should be changed.

But let me go back for a minute as a bank auditor. I thought actuaries were different from lawyers and doctors, because it seems like whenever we get reports from actuaries, they all come up different. Again, I am sure we will hear of two other people who disagree today. I think it is their right to disagree, and that is why we are having this Committee meeting.

But to go back to you, Mr. Treasurer, if I may jump ahead to the elimination of the 2 percent pension subsidy, I know in early April the Governor stated that she may be willing

to back off this. I guess hearing you talk today-- What is the position today? The 2 percent subsidy will be an issue?

TREASURER CLYMER: No. Our position is that the 2 percent subsidy will be eliminated, effective July 1.

SENATOR CASEY: Okay. Now, again, without charts here today-- Take this little portion regarding fairness. We talk about fairness. Again, is this 2 percent starting in July of this year?

TREASURER CLYMER: Yes.

SENATOR CASEY: Okay. Am I correct to say that this goes up to the first \$60,000 of someone's pay?

TREASURER CLYMER: Yes, \$60,600. That's correct.

SENATOR CASEY: Now, without embarrassing you, Mr. Treasurer, someone like you, or an administrative officer who is in the high \$100,000 bracket-- You have probably already received \$50,000 in your salary, which is--

TREASURER CLYMER: I wish I had, but I haven't.

SENATOR CASEY: Well, let's just say most administrative people. What we are saying is that these people, starting in July, in all fairness, comparing \$100,000 to \$30,000 an employee-- Isn't it going to be a little out of whack what is going to happen to them in the second six months of this year?

TREASURER CLYMER: Well, if you want to compare--

SENATOR CASEY: I can show you the chart. I can show you the little person making \$30,000 versus a person making \$80,000 to \$100,000. That is just the little start of the year 1994.

TREASURER CLYMER: Well, the answer is, overall, everyone is affected by the same 2 percent. Those people who are in the brackets that are in excess of \$60,600 are, in fact, already paying the 6 percent. Once their salaries go above \$60,600, the subsidy does not apply, and they pay the full 6

percent share. So, overall, when the subsidy on amounts under \$60,600 are eliminated, everyone will, in fact, pay that additional 2 percent.

SENATOR CASEY: Everyone will pay the additional 2 percent?

TREASURER CLYMER: No, everyone will be paying that 2 percent portion of their pension contribution. The statutory contribution is approximately 6 percent, 2 percent being subsidized up to the Social Security limit. Once that is picked up on either people who are making less than \$60,600 -- or people who are making more than \$60,600 on the amount up to that level, then everyone will, in fact, be paying the same contribution toward pension as the statute requires.

SENATOR CASEY: I hear you talking, but I don't know if I understand you. Again, are you telling me that in July, if this goes through -- and I won't use you, I will use another person in the \$80,000 to \$100,000 bracket -- we will all be paying a complete 2 percent for the remainder of the year?

TREASURER CLYMER: Everyone will be paying that 2 percent on all of their wages.

SENATOR CASEY: On all their wages, not just if they have already made the \$60,000 in wages?

TREASURER CLYMER: That's right. Everyone will be paying the 6 percent on all wages. Now, the people in excess of that are paying it now.

SENATOR CASEY: I understand it, but I am just saying, when I look at my charts, and at what I have done, and my aides-- If it starts in July-- If it starts January 1--

TREASURER CLYMER: There have been a lot of percentages thrown around. Certainly, you can look at this from the standpoint of, if you are taking somebody now paying 4 percent and 2 percent subsidized, it is going up 50 percent. And, yes, that may look like an outrageous percentage. You can compare percentages to people's salaries, but the answer is, we

are talking in terms of a subsidy that has been provided. It goes up every year, as the Social Security base goes up, and it is just not a benefit that anybody else has.

SENATOR CASEY: Mr. Treasurer, stick to the point. I know we are throwing figures around. We have heard figures from you and your actuaries. But we are here today to question you.

My question, again-- I want to make sure -- just a yes or a no -- on July 1, 2 percent goes on board. If someone making \$100,000 has already been paid \$50,000 in salary, will they then pay the 2 percent on the remaining \$50,000, or just \$10,000?

Look, I don't want to-- I'm saying--

TREASURER CLYMER: I have no problem answering your question. I just want to make sure that I understand it.

SENATOR CASEY: I just want to say, don't hurt the little person in this State government making \$30,000, \$40,000, \$50,000.

TREASURER CLYMER: If the person is over \$50,000 by July 1 -- okay? -- we assume that the employee percentage is 6 percent. They will continue paying the full 6 percent on their salary.

SENATOR CASEY: Up until the full salary?

TREASURER CLYMER: Up until the full salary, everyone will. They're paying it now.

SENATOR CASEY: Oh, yes, but I just want to see how we are going to add the 2 percent onto the employees of this State starting July 1.

TREASURER CLYMER: If a person who is in excess of that category could go above that before then-- They can't, because there aren't any wage levels that high in the State. If they went above that before July 1, they would be paying the 6 percent before July 1.

SENATOR CASEY: Just to go back, I guess in the NCSL Legislative Pension Guide, it states that pension funding should be -- whatever you want to call it -- contemporary or new obligations. The Guide also states that pay-as-you-go is diametric to the proportion that pension funding is a contemporary obligation. I want to ask the actuaries: Other than for the need to balance this year's budget, what is a public policy reason for reversing the State's policy of having the current taxpayers pay for the benefits of current employees?

TREASURER CLYMER: Are you talking about the pension, or are you talking about the medical?

SENATOR CASEY: Yes, the pension. I'm talking about the Pension Guide. I guess maybe the actuaries can answer this.

TREASURER CLYMER: I am not sure if that is the case.

SENATOR CASEY: Go ahead. It's not the case?

TREASURER CLYMER: The pension system is not -- I will let the actuaries comment on that -- going to pay-as-you-go on pensions. Pensions are still being prefunded.

SENATOR CASEY: Okay. I guess what I'm saying is, the Treasury, which is you, sir, has stated that the State needs to control public employees' pension and benefit costs. Okay? You have said that, and I agree with you. I think costs in the State of New Jersey have to be controlled.

TREASURER CLYMER: It is not a matter of-- Okay, go ahead. I am going to let you finish.

SENATOR CASEY: What I am getting at-- I am really getting into revaluation, is what I'm saying. We have people at this table--

TREASURER CLYMER: This is not a revaluation.

SENATOR CASEY: No, I am going back to the revaluation of what we are talking about. I guess I read ahead. But I think Senator Inverso, two years ago, and the Republican-controlled Legislature thought the way to go was the opposite way from what the administration is going right now.

I just wonder why the complete switch, as I think it was a good bill that you sponsored. I think it was in 1992.

TREASURER CLYMER: I'm sorry, I do not understand. This is the opposite way from the way they went a couple of years ago?

SENATOR CASEY: Yes, that is correct, as far as COLA, the elimination of prefunding, post retirement, and so forth and so on. I am just wondering: I guess administrations have a right to change, but, you know, is it something we did wrong two years ago? I wasn't up here.

TREASURER CLYMER: No. I think the policies a couple of years ago were appropriate for the time. If you look at the prefunding of the post-retirement medical, those expenses for health care were climbing into the high teens, close to 20 percent a year. That policy decision was appropriate at that time. In fact, times have changed. Those rates have come down considerably. It is simply, to go on funding at rates that are substantially above what the health care experience is right now, results in putting away far more money than is necessary to fund current benefits.

SENATOR CASEY: I guess that is what I said. I mean, I am jumping around here to get to the actuaries. Do either one of you feel that at some point the State may have to return to the prefunding method? Do you project anything in the future? Could there be a problem, like, regardless of what happens in Washington, if we ever go back to prefunding?

MR. REIMERT: Well, certainly, I think that is a possibility. Maybe I could try to answer that question by talking a little bit about what happened a few years ago. A few years ago, when the law was changed to add prefunding, I definitely supported it. I thought it was wise, and I had advocated it. To me -- and this is just my personal opinion -- from my perspective, things have changed significantly since then. That was at a time where-- It is just my personal

opinion, but I did not see a significant likelihood of any major changes in the financing of health insurance in our country.

It turns out that I was wrong. With the election of President Clinton, the campaign of 1992, clearly there is a major move underway in Washington to significantly change the way health benefits are financed. From my point of view-- My opinion is changing based on emerging events. To me, the circumstances are different, as I said earlier, from the systems I serve, which have not been prefunding up to this point.

The question I asked myself in trying to review this was: Why would I argue to somebody that it is important for the State to start prefunding in Fiscal Year '95 for the systems I work on, when it has not done that up to this point? Just looking at the circumstances today, I found it difficult to try to come up with sound reasons for why I should make that argument to look to the future. Depending on circumstances two, three, or five years out, it is quite possible that, based on what the circumstances are then, I might be advocating and supporting a return to that. I can also see that based on what might happen in Washington, it will become obvious that pay-as-you-go is perfectly sound.

SENATOR CASEY: So, again, I guess we are going to come out of this meeting with what happens in Washington. I guess in the future we can blame Washington for everything that happens in New Jersey.

Let me just say, if we continue the way we are now, except to have a great balance--

TREASURER CLYMER: I don't think that is the case.

SENATOR CASEY: Well, I keep hearing this, so I wonder.

TREASURER CLYMER: I think what we are doing-- We base our decisions on pension funding, on the current circumstances, on current experiences, on current interest

rates, on the makeup of our current employee population. These are things that are monitored on an annual/biannual basis. So we make decisions to adjust the funding of these plans either up or down, based on current circumstances. So we take a look, given the best information at that particular time. I think the decisions made several years ago may have been appropriate for those times. They have resulted in overfunding under the current circumstances. If things change two years from now, or three years from now, whatever, then it may be appropriate to change that funding level, because we are constantly doing a lookout over 20 years, or over the life of our employees, as to what allows those funds to be as healthy as they are today. We are not changing that overall philosophy. We want the funds to be healthy; we want them to continue to grow, but we want to do it in an appropriate manner.

SENATOR CASEY: Okay. I guess, really, I have two small questions: Was there a reason we didn't start in 1994, as far as beginning the pay-as-you-go funding? I mean, if we had started the pay-as-you-go funding in 1994, what would the interest costs be in 4, 5, and 6? Would there have been a major change in that? Could we have started this in 1994?

TREASURER CLYMER: Well, I guess, in essence, what we are proposing is that we do start it in 1994.

SENATOR CASEY: But not for the full year, starting at the end of July. Is that--

TREASURER CLYMER: Well, as I understand it--

MR. BAUS: No, it's '94, it's the current year.

MR. REIMERT: It would be the current year. It would be for 1994.

SENATOR CASEY: It's not the first 60, the second 60. That's what I mean.

I guess I may have more questions in the future, but let me just hear some others.

SENATOR INVERSO: Thank you, Senator Casey.

Mr. Treasurer, before I go on to another member of the Committee, I would like to ask the actuary a question: Basically, a comprehensive actuarial review is done every three years with the systems. Is that true for all systems, or is that--

MR. BAUS: Yes. There is an annual evaluation done, and then there is an experience review done every three years for each system.

SENATOR INVERSO: Is that three years an appropriate interval relative to making changes in actuarial assumptions, including how you recognize your normal costs, or is that too short a period?

MR. BAUS: I think industry practice -- and Bill may have additional comments -- is probably five years. Now, the interesting thing here in New Jersey, though-- Well, in the typical situation, the reason we use five years is because you need enough data to do an analysis on. The systems here are so large, for the most part, that you can easily get enough data in three years to do it. So I think that is really why we use three years here, and I think it is appropriate, at least for the bigger systems. I have no problem with that.

SENATOR INVERSO: Well, let me ask you another question in that regard, then: If I were to go from -- as is proposed here -- the entry age normal to the unit credit method, and three years from now I decide I want to go back to the entry age normal, is that an acceptable actuarial methodology change in a three-year interval?

MR. BAUS: I think that would be very unusual.

SENATOR INVERSO: Okay. So there are some actuarial methodologies that would not be appropriately changed in a short interval?

MR. BAUS: That is correct.

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SENATOR INVERSO: All right. One of the things that I sit here and have some concern about is, there ought to be a segregation between the actuarial assumptions that can change in a three-year interval, and there ought to be some actuarial methodologies that shouldn't change in a three-year interval. I don't know whether it is five years that is appropriate, or ten years, but I think going forward we need to look at the difference between interest assumptions and those other things that are almost fundamental to an actuarial approach to a system.

So that is one of the things that I will put on my list of things to pursue. I would like, at some point, perhaps through the Treasurer's Office, to have access to your expertise and input on that, because I think that one of the things I would like to see avoided is a kind of revolving door approach to certain fundamental actuarial elements to the pension systems we have.

I have one other question, Mr. Treasurer, before I forget, and before you leave here: As you know, we are going to hear input from other sources today. Would you -- certainly I hope you would -- be amenable to, after this meeting, sitting down with, let's say, representatives of those groups, whether it is the NJEA, the CWA, or whatever, through their representatives, and, in essence, let's have an opportunity to share what some of the concerns, and maybe even alternative suggestions are, in kind of a workshop setting, so that we can at least put everything on the table and go forward.

This is fine. This is a public airing. It allows questions and answers. But I think at some point beyond this, once we have gotten all the positions, in essence, established, that we ought to sit down and see if we can craft something that, you know, makes sense to the larger body. It may not be

possible, but I do think it would be an appropriate next step if we could have such a meeting, under your auspices.

TREASURER CLYMER: That is perfectly acceptable, Mr. Chairman. Our resources and offices have been opened to meetings in the past. We have made ourselves available to any group representing the employees that has wished to sit down and talk with us. We would certainly look forward to doing that as part of this Committee's process, and as part of coming to a resolution of some of these open issues.

SENATOR INVERSO: I'm glad you concur with that. I think I would ask that we arrange to have something done as quickly as possible after this meeting is over -- and hopefully we can get it all in today. I would ask that each of the concerned parties-- If they would approach me, we could determine who they would like to have represented in this type of a setting. And I can furnish that, then, to you. I think we are talking about something as quickly as within a week or so. I just don't want to have the process criticized as not being an open process. That is not my style; it is not the administration's style. I know that. I think it would be an important next step to have such a process occur. I don't mind complimenting myself, obviously, and, Senator Kenny, you picked up on that. But I just wanted that for the record, because that is the way it should be.

TREASURER CLYMER: I think that is very appropriate, and we will make ourselves available.

SENATOR INVERSO: Thank you.

Senator LaRossa?

SENATOR LaROSSA: Thank you, Mr. Chairman.

Mr. Treasurer, Margie, good morning. I am looking at one of the charts -- I think one that was up there -- in terms of current law, and it also takes the percentage of cost compared to the employee and the employer. It has a very, very large disparity in the first year. You indicated that over a

period of time, in subsequent years, those lines would begin to converge again. Next year, it will be based on the 2 percent. It goes through a comparison where it was 37 versus 62, employee to employer for '94, versus 6 percent.

You indicated it is the-- I don't know if this is one of your--

TREASURER CLYMER: That is the OLS chart.

SENATOR LaROSSA: Yes. The one-year is an unfair comparison. I know you indicated yesterday that the-- Actually, it is the Governor's pension funding end quote.

SENATOR INVERSO: What page are you on, Dick?

SENATOR LaROSSA: Page 11. I think it was on page 40, if that is the-- Is that the interdepartmental?

MS. McMAHON: Yes.

SENATOR LaROSSA: Page 40--

SENATOR INVERSO: Pages 48 and 49.

SENATOR LaROSSA: Somewhere in the high 40s.

SENATOR INVERSO: Do you mean the contribution rates?

SENATOR LaROSSA: Yes.

SENATOR INVERSO: Yes, pages 48 and 49 of the interdepartmental.

SENATOR LaROSSA: I think a lot of what we are hearing today is that if you look at one aspect in isolation, the entire picture, a case can be made for, you know, major problems. But again, you can't look at one aspect. You have to look at it in the context of everything else. So if this is a one-year, over a period of two, three, five, ten years, at what point do these numbers begin to converge and become more balanced from an equity standpoint, instead of having that wide of a disparity? You indicated yesterday that this was one year that they would begin to merge.

TREASURER CLYMER: I am going to let Mr. Baus respond to that. He talked about that yesterday. Again, these are not numbers that were created by us. Irrespective of the 2

percent, there are disparities that exist between classes of employees and different funds. Those are things that have evolved over time. So I caution the Committee about looking and trying to draw too many conclusions from this 2 percent issue in the context of the relationship. We are trying to create some equity between the systems that have evolved differently over a large number of years.

Bob?

MR. BAUS: Senator, two comments, I guess: First, the OLS presentation indicates that the current employee rates are around 4.5 percent to 5 percent. Their analysis is okay. I mean, it is correct, because what they have done is look at one year. In fact, the long-term employee contribution rates are closer to 4 percent. In one system, it is slightly under; in another system, it is slightly over the 4 percent. So as a starting point, when we would do this kind of an analysis, we came up with a different relationship. I think instead of-- You know, they are showing 6 percent and 15 percent as the employee portion. I think we would probably be up closer to 20 percent or so in doing it now. But that is still fairly far out of line.

I think it is fair to say -- we took a look at this last night -- that certainly within 10 years they would be at 50/50. It might even be sooner than that. It might be in the 6- to 10-year range they will come back to 50/50, and they will continue to grow. The employer relationship to the employee contribution will actually get back closer to where it is right now. It may not be quite -- probably 60/40 ultimately, something like that.

SENATOR LaROSSA: My point was, it looks to be very disproportionate, but when you go five years out or ten years out, it becomes further back in balance. Realizing that it is an OLS number, maybe we should ask OLS to somehow give us a

10-year projection, to see how those numbers may match up a little bit better.

One of the comments that I keep reading -- and, quite frankly, I don't remember we have been reading so much on this particular issue-- I have a fairly good idea of where it came from. It was in one of the analyses we have read. It was something to the effect that, "Every dollar not spent, or contributed today, is a dollar that will need to be spent in the future." I think that has to do, perhaps, with some of the return in terms of the equity and the ability to have money on deposit and have it be reinvested and generate and accrue more value as we move forward.

If, in fact, that line does not cross until the year 2017-- Then you said that even after it crosses, it is a couple of years and then it comes back and kind of restabilizes. Is that an accurate characterization? I mean, is this one of those things that, yes, you can make a statement and somewhere down the road it will hold true, but this is something -- again, a characterization with regard to the value of the system, the amount of liabilities that are applied against the system? In fact, is there enough value in the system that, in fact, that statement is or isn't true?

TREASURER CLYMER: Let me give you my answer, and I will then allow the actuaries to comment or correct me.

I think the statement that a dollar not spent today, is a dollar that has to be spent in the future-- It could be correct. From our perspective, looking at it right now, it is absolutely not correct. It is something that, over time, could change, depending on what happens with the assumptions, what happens with a change in interest rates. Currently, if we wrapped up the plans right now, if we stopped, there is enough money to pay everyone, right now, without putting any more money into the systems. If we look at what we know currently today, what the current trends are right now, then I think that

characterization is incorrect; that there is more money in the plans right now; and, in fact, the plans will continue to grow healthier under the current proposal.

MR. BAUS: I think that is exactly right. I mean, right now, you have more money than you need if the plans were shut down. That is prudent, because the plans are not going to be shut down; they are going to continue.

As to whether a dollar not spent today is a dollar that has to be spent later, I don't think that is correct. The current methodology, based on our projections, is going to drive the funded ratio to, say, 115 percent; whereas, the proposed methodologies are going to drive it to 105 percent. So the question becomes: Do you want to spend the extra 10 percent or not? I mean, it is a question of how secure you want the fund to be. So I do not think, in this case, based on our projections, that that is correct.

The Treasurer is right, though. Things can change. You know, it may turn out that the projections are inaccurate for one reason or another. But based on what we are looking at right now, it is just a question of how much security you want in the system, how much extra you want to have.

SENATOR LaROSSA: Okay. So, basically, you are building up a pad, if you will, by continuing those contributions which really are necessary to meet the obligations. Is that an accurate characterization?

MR. BAUS: Correct.

TREASURER CLYMER: That is exactly the point. I mean, our concern is in two areas. One, the pension area, that within a number of years you are talking about an extra billion dollars a year, which is \$350 for every household in the pay-as-you-go, and not making those changes on the health care. That becomes an extra billion dollars a year, which is also \$350 per household. So you would have every household in New Jersey paying an extra \$700 a year just for those two

benefits, and it would be increasing. Under current circumstances, those dollars would not be needed. That, I think, is an awful lot to ask of our taxpayers, just to have a pad.

Mr. Reimert has a comment.

MR. REIMERT: If I may just add one thing to that: I think, in talking about some of these targets, the ADOs and the PBOs-- Exactly what are these targets, and what does 100, 105, or 115 mean? At least with respect to the PBO, for a private-sector employer covered under ERISA, if they were using the projected unit credit cost, which is what this proposal would entail, once they hit 100 percent funding, they would be precluded by law from putting more money into the fund, and they could only continue to contribute to the extent that it would be bringing them back up to the 100 percent level.

So I think it is important not to look at some of these measures as, well, 110, 120, or 130 of the PBO is better, and then we just want more and more and more. I think it is important to start focusing on some of these targets as sort of the maximum funding level targets. I mean, I do not want to blow that too far out of proportion, but being 100 percent of PBO is quite well-funded.

SENATOR LaROSSA: I think probably the biggest concern, and, you know, we can argue the point back and forth as to what is prudent and what is not prudent, which methodology is appropriate, and so on-- But I guess the bottom line, in everybody's mind, has to be finding some way to guarantee both the solvency and the integrity of these pension systems. I believe that ultimately that has to be the bottom line, regardless of what the methodology is.

Is there anything in your mind-- Going back, you said that three years, because of the size of the systems, might be a short enough time frame to do that kind of a review. Are there any techniques, either legislatively as they relate to

these proposals, or any ideas you may want to offer now, or consider and hold them for another meeting? Or, do we have enough safeguards to guarantee that solvency and integrity? I mean, again, I understand what you're saying. If you have two routes you can take to get to the same destination, the question is: Which route do you want to take? Because somebody doesn't like it is not the answer. The question is guaranteeing -- I'm using that word, and I can't emphasize the word strongly enough -- or as much as you can possibly guarantee under any set of circumstances, the solvency and integrity of these systems.

TREASURER CLYMER: Well, there are a lot of things you can do to "guarantee." I mean, it is often said that there are no guarantees in life, but to the extent there are, this is probably about as close as you can get, because of the way it is monitored, because of the annual evaluations, because of where we stand from an asset perspective now to other plans around. I think, as Bill indicated, coming up to 100 percent funding under the PBO method, which, again, assumes a 6 percent raise for every employee, every working year of their lives, is a very, very conservative funding level, because those kinds of increases just aren't going to happen.

So in terms of having a guarantee, you could be more guaranteed. We could have the plans 150 percent funded and have \$20 billion in there, more than we could ever possibly need. Yes, that would be a more ironclad guarantee than being 100 percent funded, but the question becomes: Is it a wise expenditure of taxpayer dollars?

SENATOR LaROSSA: I guess what I am driving at is, if you are talking about two years ago in terms of, you know, times change, and when the inflation rate relative to health costs goes into the high teens, and then it goes to 20 percent, and now it has dropped considerably-- Let's say general inflation goes up tremendously as well, and it affects the

interest rates in terms of what the return is on these particular investments, and that perhaps drives up the need for those increased contributions. Is that part of the entire review process? There is not one thing in particular, but that is just part of the entire review process?

You have to forgive me, but not being an accountant or an actuary-- These may be very, very mundane questions but, again, I am just trying to get a layman's perspective on this.

TREASURER CLYMER: Well, I think if we look at the charts we had here that showed what happens in the change in the PBO method and the ADO method under the current proposal and under the new proposal, you will see that, in fact, they both curve up. They both continue to climb up, so that even under the changes, the percentage funding in the plans continues to go up. I think as long as you are above that level, that they are not going down, and, in fact, that assets in terms of percentage funding are continuing to go up, you can rest fairly well-assured that the plan is safeguarded from any exposure or any downside risk.

SENATOR LaROSSA: Okay. Mr. Chairman, I may have one or two other questions, but for right now, thank you. Thank you, Mr. Treasurer.

SENATOR INVERSO: Senator Kenny?

SENATOR KENNY: Thank you, Mr. Chairman, and hello again, Treasurer. It is good to see you today.

I try to find the politics in issues. When you remove the actuaries and the auditors from things, I try to find out what the political motivation is. I think I voted against the reval in 1992. That was in the Assembly then; it was Speaker Haytaian's initiative. I think Richard Bagger was the sponsor. I recall getting up and questioning it, because I thought, at the time, that I would have liked to have seen some of those dollars going into it go to property tax relief. We had questions about--

TREASURER CLYMER: You were not questioning the revaluation, only the use of the funds?

SENATOR KENNY: I was questioning the amount of money going into various aspects of the pension systems behind the reval. It was a Republican initiative, with Speaker Haytaian, who stood behind this system that you are now changing.

TREASURER CLYMER: We are not changing it, by the way. The benefits are all exactly the same; they have not changed.

SENATOR KENNY: Well, there are changes here that were supported by the Republican Legislature in '92, which I think are going to be affected by this legislation in terms of the prefunding of cost-of-living increases, the rate of the prefunding, and the elimination of the prefunding of medical benefits.

TREASURER CLYMER: The prefunding itself is not a benefit. It is only a method to assure that the benefit can be paid. In fact, the State still has the benefit on the books to pay post-retirement medical. The post-retirement medical expense is, itself, the benefit. How you get there is a business decision that you, the Legislature, and we, the executive branch, have to make.

SENATOR KENNY: Some people feel that how you get there also goes to the integrity of the benefit, and that the rate at which you fund things has to do with the very integrity of the benefit itself. I mean, that is an issue. It is not that you are changing the benefit ultimately. You are changing the rate at which you are funding things. In terms of the medical benefits, of course, you are not prefunding them at all.

So those are issues that have been changed since 1992. What I am saying is-- (interruption caused by a woman's voice coming through the speaker in the room from another committee meeting)

SENATOR INVERSO: That tells you where the preference is on today's meeting. That's amazing. I wonder if it is our phone line here. Why don't we see if we can continue over and above that? Actually, she is much more eloquent than you are. (laughter)

SENATOR KENNY: We can't compete with a child. (referring to what is being said over speaker)

The point I was making is that-- (same type interruption at this point)

SENATOR INVERSO: Senator Kenny, we swear this was not planned -- honestly.

SENATOR KENNY: This is definitely another plot to silence me, just when I get the microphone.

SENATOR LaROSSA: Another Republican plot. (laughter)

SENATOR KENNY: You have outfoxed me once again, Mr. Chairman.

SENATOR INVERSO: Where is that coming from? Oh, it's up there.

SENATOR LaROSSA: It is coming from another one of the meetings, obviously.

SENATOR INVERSO: Yes, another committee meeting.

You know, Senator Kenny -- this is an aside, but it is going to come in later -- it is maybe academic, but the initiative was an administration initiative a couple of years ago that, obviously, had to go through the Republican Legislature. In that process, we thought we had made some changes to what the administration had proposed which, in essence, made it a better bill. There were some governance items that we wanted to see in there with regard to the composition of the trustees, with regard to the selection of actuary, things like that.

Yes, we will take full credit, or blame, depending upon who is judging us, with regard to that. But the

initiative with regard to revaluation was something that the administration initiated. I think you know that.

SENATOR KENNY: I really don't know that.

SENATOR INVERSO: I thought you did.

SENATOR KENNY: I don't know what occurred between the Governor, the Speaker, and the Senate President. I don't know, and I don't think you do either. I mean, we don't know what happened behind those closed doors.

SENATOR INVERSO: Well, okay.

SENATOR KENNY: So I don't think it is fair to speculate. We only have to stand on who was out front.

SENATOR INVERSO: It was--

SENATOR KENNY: The Speaker was. I would like to know-- I guess we are going to find out what the Speaker's position is now.

SENATOR INVERSO: I think the record shows very clearly that it was an initiative of the administration that was followed through by the Legislature. No question about that.

Do you want to continue with your questioning?

SENATOR KENNY: Yes. Two quick points, though: When you leave, would you mind leaving your charts behind, so that we can question on the charts of other people who follow you? Would that be acceptable to the Chair?

SENATOR INVERSO: Absolutely.

SENATOR KENNY: Okay, thank you.

A question that was raised by the Chairman -- I just want to clarify it. Did the Governor, the front office, discuss all of these changes with the affected workers' groups before they were put forward as they were? Were there discussions? Were there sit-downs? Were there efforts made to iron out what may have been differences that are now being raised, in the past? Was that done?

TREASURER CLYMER: There have been discussions. I would say that probably more have happened since the presentation of the budget than prior to that. I would point out, as was stated often, it was not a process that was particularly desirable, not in keeping with the Governor's desire to sit down with people ahead of time, and certainly not one that we intend to follow in the future. But the fact of the matter is, we came in with five or six weeks to put a budget together. There were any number of groups not only in this area, but in other areas of the budget, that we also did not have an opportunity to sit down with ahead of time.

We did meet with some of these groups ahead of time. In some cases, the pension things were not the subject of the conversations, so I would not sit here and claim that all these things had had the airing that we would have liked them to have had prior to making the presentation.

SENATOR KENNY: So the plan here was not discussed with the experts from the various pension groups that are affected by this?

TREASURER CLYMER: I am not sure what process-- The transition team had talks with any number of people, people from the outside. I cannot tell you what groups were consulted and what groups were not consulted. Certainly, there was a lot of speculation as to what was going on, so I assume that a lot of people who may not have been directly in the loop, or somehow indirectly in the loop, were certainly aware of the process.

SENATOR KENNY: Now, there is a chart that was up there before. I think that may be it on the floor right there. Is that the one? Okay. What are the assumptions that go into those two lines?

TREASURER CLYMER: This is the projected post-retirement medical contributions.

SENATOR KENNY: Right.

TREASURER CLYMER: The assumption, the dark line, is the current trend of funding post-retirement medical, which assumes 100 percent funding by the year 2005. The dotted line is revised to pay-as-you-go. That is based on health care costs going up at approximately 6 percent a year.

SENATOR KENNY: What is the projection on health care costs going up on the dark line?

TREASURER CLYMER: That was projected out several years ago at--

MS. McMAHON: Twelve.

MR. BAUS: It starts at 12 percent; it goes down to 7 percent.

SENATOR KENNY: Twelve percent. So then the two lines are not really based on the same assumptions. Isn't that correct?

TREASURER CLYMER: Absolutely not.

SENATOR KENNY: Right. I think that is -- not out of your characterization -- rather misleading. What if you took that dark line and put it at 6 percent? What would that graph then look like?

TREASURER CLYMER: Well, if you brought down the line characterized-- One is a prefunding, which is an accumulation of dollars; the other, which is paying out current dollars--

SENATOR KENNY: I understand that, but--

TREASURER CLYMER: So there are several different assumptions there.

SENATOR KENNY: No, no, no. I want--

TREASURER CLYMER: The interest rate is only one of the different--

SENATOR KENNY: Mr. Treasurer, let me ask the question.

SENATOR INVERSO: I think it is getting to the issue of what I asked earlier about the 6 percent, if that had been factored in on a prefunding basis.

SENATOR KENNY: The question is: What would be the savings if you did an assumption of 6 percent on the present system?

TREASURER CLYMER: On a prefunding basis?

SENATOR KENNY: Right.

TREASURER CLYMER: It would be a line in-between those two lines.

SENATOR KENNY: Okay. So why didn't you do that? Why don't you recommend to us that we do a 6 percent medical inflation rate, rather than a 12 percent? Why don't we adjust the assumption, rather than change the whole mechanism of funding?

TREASURER CLYMER: Because if you look at that, it still creates an overfunding of the system based on the pay-as-you-go method. The pay-as-you-go method, based on the current rates of increase being experienced for medical care, indicates that there is not a crossover; that the line is flat enough that we do not need to put away excess assets for no purpose, at any level, whether it is a level--

SENATOR KENNY: Why are you being so aggressive in changing the assumption on medical costs for the pay-as-you-go, but yet on the current system you go 12 percent? It seems to me that what you are trying to do is maximize the cost differential, because you are using different assumptions on each line.

TREASURER CLYMER: No, no, no.

SENATOR KENNY: That is a pretty significant--

TREASURER CLYMER: No, we can put the hypothetical lines there if you would like to see them. The black line is not a hypothetical line. It was not based on anything we picked. It is, in fact, the current method. What we opted to show was not a lot of hypotheticals in-between. If you would like, we can change methods--

SENATOR KENNY: Why don't you recommend to us that the 6 percent assumption on medical cost increases, which you say is, in fact, the assumption that will prevail over the near future-- Why don't you recommend that, and allow us, as the Legislature, to perhaps adopt that and vary other assumptions that wouldn't be as dramatic and as aggressive as what you are recommending here?

TREASURER CLYMER: It is not a matter of being aggressive; it is a matter of being reasonable. The reason we did not recommend a line in-between, which would be the current rate, again, at prefunding -- which is what you are suggesting -- is because it socks away dollars that are not needed right now. We do not feel that this would be prudent. We do not feel that the taxpayers need to come up with the additional dollars, at whatever level, at this time. It is just not a prudent way to go.

So, yes, we could have recommended lines in-between that. This is not an attempt to rule out anything that you may want to look at. It is simply where you are now and what's happening, what the current facts are against what we have recommended. There could be recommended levels in-between. Again, our feeling is, at this recommended level, on the pay-as-you-go, we are putting up the money as necessary. By recommending a level that would be the lower experience in health care, but still prefunding, we would be putting away more dollars than we feel are necessary to ensure the security of that benefit.

SENATOR KENNY: I think the reason for the way the lines are being construed, or constructed, is politics. I am concerned that, you know, Wall Street has cited your proposal as being a concern. It is cited in both Moody's and Standard & Poor's and in the editorial today in The Bergen Record. I know we are not appreciated when we quote from the press, but we in the Minority have to rely on all the resources that are out

there. They say that the bond rating houses are critical of the proposed reduction in contributions, blah, blah, blah.

Now, let me finish. So how you propose to do this goes to the very integrity of the budget. The reason I think you want to do it, is because of the savings that you get into this year's budget by keeping one line at 12 percent and the other at 6 percent. How much are you taking out of pension savings and putting into this year's and next year's budgets, based on this proposal?

TREASURER CLYMER: If you are asking the composite of all the pension changes, the health care changes, and the pension subsidy reduction of all six items that I mentioned, it is approximately \$1.3 billion through the end of this year and the next fiscal year.

SENATOR KENNY: How much is that driving your policy decisions?

TREASURER CLYMER: At the moment, it is obviously an integral part, because we presented the budget.

SENATOR KENNY: And you reduced the income tax.

TREASURER CLYMER: If these changes had not been prudent and we did not look at a revaluation of the assets-- Even though at the end of the year the stock market might have allowed that kind of an approach, we didn't think we wanted to do that, that it was appropriate. If they hadn't been there, they wouldn't be on the table right now. We looked at any number of changes to the budgets. We had another \$500 million, \$600 million, or a billion dollars' worth of cuts, that were on the table, that were rejected because we didn't feel they were appropriate. We looked at these, and felt they were not appropriate.

This chart is not politics. It is simply what currently exists now, which is a fact, and what we proposed, which is also a fact. That is not political. In terms of what Moody's put on the table, Moody's also talked about controlling

the growth of Medicaid expenditures. They also talked about achieving expenditure reductions at the municipal and school district levels as well, which calls for controlling those levels. So there were any number of areas that Moody's talked about in terms of their future concerns. They got all those future concerns by talking with us, because we told them what our concerns were.

SENATOR KENNY: Treasurer, I'm sure that you have done a good job in many areas. I am not questioning the good things you have done. I have given credit where credit was due many times. What I am concerned about is, we are making a dramatic change that has upset a lot of people. These are State workers, teachers, people who rely on these things. Whether anyone thinks they shouldn't have, or otherwise, they certainly relied in good faith, and we are making a dramatic change that, perhaps, does not have to be made.

Just on this chart alone, if you had just done that upper line at 6 percent, instead of 12 percent, the ramifications would not be so severe. I submit that the reason you kept the upper line at 12 percent was because it enables you to take \$400 million in assets from the Post-Retirement Medical Prefunding Account to use in the Fiscal Year 1994-1995 budget. If you lowered that to 6 percent, you would have less money to do that with. I think that is the reason you did it, which is fine. I mean, that's politics.

All I want to say, is that this process is being driven by politics, by balancing the budget, because you lowered the income tax. So in order to enable the Governor to go around the country making speeches about cutting taxes, we are doing this to our pension system in a more aggressive fashion than we otherwise would have to. Nobody on this side of the aisle disagrees that the pension system should be looked at, and perhaps reformed. Our disagreement is that it is far

too aggressive and too intrusive on people with vested rights than otherwise it would have to be, because of the Governor's budget. That is the only point I am making here today.

A concluding point: The Governor said she was going to have an open government. She campaigned on that; criticized Jim Florio for being closed. She comes into office and -- a whole series of things, but on this particular thing, a closed door, and most of these people probably voted for her. You know, a closed door as to revamping the pension system--

SENATOR INVERSO: Senator Kenny, I have given you a lot of latitude, and you know I always do, but let's talk about the pension proposal. Let's not talk about open and closed doors. The Treasurer has already indicated earlier today--

SENATOR KENNY: The Governor made access an issue, I didn't.

SENATOR INVERSO: All right, well, but the Treasurer has already indicated that he, in going forward, will meet with the affected parties here as a result of the public testimony and input we receive today. Let the process continue.

I understand the rhetoric; I understand the politics; I understand it all.

SENATOR KENNY: It's not rhetoric; it's not rhetoric. I mean, it is not rhetoric.

SENATOR INVERSO: But let's talk about the pension proposal.

SENATOR KENNY: Why is it that when we criticize something, it is characterized as rhetorical?

SENATOR INVERSO: Let's talk about the proposal.

SENATOR KENNY: Yet, when someone says something in favor of the government, it is taken as gospel.

SENATOR INVERSO: No, no, no. I allowed you a lot of latitude.

SENATOR KENNY: You cannot render a criticism without it being called rhetorical.

SENATOR INVERSO: Senator Kenny, I allowed you to comment about what was driving this. I allowed you to comment about the tax reduction.

SENATOR KENNY: This is hundreds of millions of dollars we're talking about here. Is that rhetorical?

SENATOR INVERSO: Now you are talking about something else -- the Governor's open process. Let's talk about the pension proposal.

SENATOR KENNY: Well, why not? That is on the table. I mean, they brag about their open process.

SENATOR INVERSO: The process is open, and it will continue. The Treasurer has already indicated that the process will continue.

SENATOR KENNY: The horse is out of the barn, and you know it.

SENATOR INVERSO: Do you have any more questions on this proposal?

SENATOR KENNY: Final point; this will be my last point: The Governor said, in the summer, that it would be irresponsible to have an income tax cut in New Jersey, given the state of our financial condition. She gets elected; we all know the history; and we're going forward with it. It is still irresponsible to do what she did and what she is planning to do. This is just one of a number of places where that irresponsibility is being shown.

Thank you.

SENATOR INVERSO: Are there any other questions? Senator Casey?

SENATOR CASEY: No, just to you, Mr. Chairman. I agree with the Treasurer. If there are more meetings coming up and the budget is out, aren't we kidding ourselves. I mean, these meetings--

SENATOR INVERSO: No, we are not kidding ourselves. I hope that is not the case. That is your characterization.

SENATOR CASEY: No, no. Mr. Chairman, I don't want to put you on the spot, but if there is a meeting tomorrow, or Thursday, or something, and we actually see changes that this Committee, on both sides of the aisle, could agree on, is there a possibility of changing this?

Mr. Treasurer, I think we know there would be a very small possibility. Is that correct?

TREASURER CLYMER: No. We have indicated that we will exercise, you know, a great deal of latitude in dealing with the committees. Ultimately, our objective is to balance the budget. We want to see the budget balanced, and that is part of our goal. So, within the parameters of balancing the budget, yes, we are open to change.

SENATOR CASEY: I don't want to sound like I don't want to balance the budget. What I am saying is, any changes to any of these charts here, and balancing the budget would have to come from other areas. Is that correct?

TREASURER CLYMER: Assuming that you, as a Legislature, can agree and we can agree on those other areas, then that's fine.

SENATOR CASEY: Okay, that is what I wanted to say. So there will be meetings as soon as possible with this Committee--

SENATOR INVERSO: Well, first of all to occur, I would hope, would be a meeting with the parties, the administration, and representatives, to see what alternatives can be put out there and if we can forge some approach that we can all live with. It may not be possible, but at least the opportunity ought to be there to have this dialogue.

You are faulted for having it, and you are faulted for not having it. I guess you are just faulted here in this business.

Are there any other questions of the Treasurer and his group?

SENATOR CASEY: Well, Mr. Chairman, that is correct, but faulting affecting 340--some thousand people in the State of New Jersey -- whatever the total is -- is a process that should take a little bit of time.

SENATOR INVERSO: Absolutely.

SENATOR CASEY: Maybe it should have been done two or three weeks ago, or maybe a month. That is all I'm saying. I don't want to sit here telling all the press why we're here, when nothing can be done about it. That is what I want to make very clear.

You're saying there is a possibility, with the right changes in the right areas, that there could possibly be changes within the budget. Is that correct, sir?

TREASURER CLYMER: Yes.

SENATOR CASEY: Okay. Thank you.

SENATOR INVERSO: Thank you, Treasurer. Thank you, actuaries.

You are welcome to stay, but I know you have a busy schedule, Treasurer.

SENATOR KENNY: Mr. Chairman, we request them to leave the charts behind.

SENATOR INVERSO: Yes, if they have no problem with that.

Just so you know, we have arranged with the CWA to have their actuary, Mr. Poulin, provide us with his commentary by phone. They asked for permission to do that, and I thought it would be appropriate. He couldn't make it here today. That is why the phone is here. He will provide it on a speaker phone. We were scheduled to have him do it around 11:30. I held off until 12:00, not knowing how long the Treasurer would be here. So we will get his input at 12:00.

Mr. Kaufman, are you here?

A L A N K A U F M A N: (speaking from audience) Yes.

SENATOR INVERSO: Do you have any other comments, or any other presentation you wish to make so we can lead into 12:00, or should I go to Mr. Testa?

MR. KAUFMAN: Why don't you--

SENATOR INVERSO: But I would hate to interrupt them midstream.

MR. KAUFMAN: Given the time element, it might make more sense to allow Bob Pursell and myself to--

SENATOR INVERSO: Okay. You have some presentation--

MR. KAUFMAN: --make our comments, because that will be within 20 minutes of when Mr. Poulin will call.

SENATOR INVERSO: That was my thought.

R O B E R T W. P U R S E L L: I'm Bob Pursell, Area Director for the Communications Workers of America. We have 50,000 workers affected by the proposals that are under discussion. Alan and Mr. Poulin will address the actuarial aspects of the proposals. What I would like to deal with are some of the process problems we have experienced, and give our perspectives. We appreciate the opportunity to do this. This is something that is very troubling to us, because we believe that collective bargaining is a valuable tool to both government and workers. What we see happening is, what has been negotiated is being jeopardized by this process.

I think Senator Casey asked the Treasurer as to whether or not there was a contract regarding the 2 percent--

SENATOR INVERSO: I think I did.

MR. PURSELL: It has been referred to as a subsidy, which really grates against us, because we don't negotiate subsidies. Subsidies, in our mind, raise the prospect of something that the tobacco industry gets, rather than something a public worker has worked for and is expected to receive as a result of complex negotiations over the years.

I have a number of documents that I would like to go through, just briefly, to illustrate how we feel about the system, if I may.

The first is a copy of what is entitled, "Tentative Agreement Between the Communications Workers of America and the State of New Jersey for Collective Negotiations Agreements, July 1, 1992 through June 30, 1995." Senator Inverso, you, in particular, know the complex negotiations we went through in '92 regarding the pension system revaluation. At the same time that that reval was taking place, we were in the process of negotiating this contract that we are currently operating under.

As part of the negotiations, this is a signed agreement of 12 pages. On the 12th page is the signature of Mel Gelade, who was then the Director of the Office of Employee Relations, whose unclassified appointment was terminated by the Treasurer when he came in. So he is not here to attest to what was negotiated. But his signature is on that page, along with our Vice President.

In section "N," which I believe starts on page 8, there is a paragraph-- This is the document that settled our contract on June 8 -- June 10, I guess it was, of 1992. There is a paragraph regarding pensions. As a result of negotiations, we reduced the writing. The agreements that were being struck in the Legislature, and with the administration, and with the unions regarding the revaluation-- As you can see, it states that we would support a revenue-neutral pension proposal.

In the subparagraphs, it provided for a 10-year phase in of COLA, which is the cost-of-living allowance that the Treasurer is proposing be decelerated; a 20-year phase in of medical benefits, which is being proposed to be eliminated; and a guaranteed benefit level, which, as far as we are concerned -- and I think it is substantiated by other documents-- A 2 percent offset is certainly a benefit that our members enjoy. I don't think anyone can argue that it is anything but a benefit. It has been incorrectly characterized as a subsidy, and you will hear more testimony from other unions today as to

how that 2 percent came to be and what it constituted. It was certainly, at the time it was implemented, in lieu of a wage increase, and to take it away, at this point, is a wage decrease. We cannot look at it any other way.

This document, which was signed on June 10, 1992, covers the period through June 30, 1995. As far as we are concerned, our benefits are locked into a contract. We can only look at this as jeopardizing the sanctity of the collective bargaining process, if we can sign an agreement a year and a half ago and now see it abrogated by a new administration coming in.

Now, following the Tentative Agreement, there is a letter we sent to Governor Whitman on March 17 pointing this document out to her, and pointing out to her that during the campaign, she had campaigned on the premise that workers should expect benefits negotiated in good faith to be fully and expeditiously enforced. After that letter, there was a policy statement which was issued by her campaign, which dealt with collective bargaining and labor relations. There was no "open door" policy prior to this budget coming out. There was never any word mentioned to us that the pension system was going to be used to balance this budget.

Granted, we had heard rumors that that was what was intended, but nobody ever came to us and said, "We realize that you negotiated a complex agreement in 1992. We are facing a budget deficit, and we need to reopen negotiations." No, they unilaterally decided to put out these proposals which, frankly, have severely damaged our ability to work with the administration.

I know you were sitting at a roundtable meeting that the Governor formed prior to the budget being announced. She asked for input from the unions as to how they felt. I think there was uniform opposition to the Governor using the pension system or the health benefit system to balance the budget. She

did not indicate that-- I mean, she listened, and she did not indicate that she wouldn't do it. But we feel there was some obligation, despite the court decisions that came out as to how pensions should be dealt with in the collective bargaining agreement; that once you enter into an agreement -- and this is in writing, I don't know how anyone can dispute that -- with them, it has to be honored. We are just puzzled as to why we can negotiate a contract, and the following administration comes in and feels that they have no obligation to honor it.

Now, there is also attached, and it comes out of this benefit package that the State provides to workers when they are hired-- It is entitled, "Highlight of your Benefits Program." We copied a section here that talks about the assigned contribution rate being decreased by 2 percent. It is clearly part of the benefit package.

SENATOR INVERSO: What page is that on? Oh, I have it, okay.

MR. PURSELL: It is entitled "PERS." It is on page 6, the second full paragraph on the sheet. You know, even setting aside whether we have a contract right to this or not, people are hired and they are given benefit packages when they are hired that say, "This is what the terms and conditions of employment are going to be." Now, I don't know why the courts feel that they don't have to honor that kind of an obligation; that they think the pension system is something that can just be dipped into by the Legislature to balance budgets.

But there is a bigger question as to what kind of employment system we are operating, when someone can be hired and expect 25 years later to obtain a pension that is going to be fully funded, when in midstream the 2 percent, which is certainly a benefit, is proposed to be eliminated, and the remaining pension system reform proposals -- which we will get into later -- severely jeopardize the ability of the State to

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fund the benefits that were promised the workers who were hired under the premise that they were going to get that when they retired.

These are questions that really trouble the union as to how this process has taken off. Maybe there is a way to put it together. We appreciate your offer to get people together to deal with this, but something needs to be done to address this.

SENATOR INVERSO: Well, I would agree, you know, that people should talk, and this is what we are doing here, hopefully.

Bob, in all fairness, the system isn't jeopardized. I mean, that is a characterization you are making. It is clear from the data that benefits are not being reduced. I mean, the 2 percent-- We could talk about that as to whether it is a benefit intended by the phrase, "guaranteed benefit levels." You are interpreting that as the 2 percent being a part of that. I could say, under the caption of "Pension," that a benefit level is your pension -- is whatever you are guaranteed to have going forward.

MR. PURSELL: You could say that if you were not part of the negotiations.

SENATOR INVERSO: I think it is reasonable to debate that. The real issue here, quite honestly -- and we all know it -- is, is this a prelude. Is this a prelude going forward to the diminution of benefits? The administration has said, very clearly, again-- I mean, what they are saying is that this is not that. But that is really the underlying concern here, with all these methodology changes: whether there is going to be a position later on that the plan isn't providing -- does not have as big a cushion as it needs to either enhance benefits or to maintain the level of benefits. But nothing we are hearing today indicates that that is where the administration is going.

MR. PURSELL: Well, I guess you have to understand our anxiety over an administration that doesn't talk to us whatsoever about abrogating an agreement that we reached. Then, subsequent to this proposal being announced, the Governor says, "Well, we want to amend the collective bargaining law, so that we can deal with pensions in negotiations." I mean, why didn't they amend the law prior to this and deal with this, if that was what they wanted to do? It is kind of hard after--

SENATOR INVERSO: I don't argue that you shouldn't be alarmed or that you shouldn't be here taking this position, because, obviously, that is where you are coming from, and that is your obligation -- not only your obligation, but that is your prerogative here today.

I hear what you're saying. Do you have anything else before the actuary comes in? I will ask if there are questions from the Committee.

MR. PURSELL: The final document in this package is the last page, which is a photocopy of the "Maintenance of Benefits" article in our collective bargaining agreement. This states, in paragraph "A," that: "The fringe benefits, which are substantially uniform in their application to employees in the unit, and which are currently provided to those employees, such as the health benefits, life insurance, and their like, shall remain in effect without diminution during the term of this agreement, unless modified herein or by subsequent agreement of the parties."

To us, that means that we have a contract, and for three years we should be able to expect that it will be negotiated, that it is going to be there. Nobody--

SENATOR INVERSO: I would do this, Bob-- I am going to ask staff to take the questions you have raised, and ask the administration to respond--

MR. PURSELL: Good.

SENATOR INVERSO: --particularly with regard to those three items that you mentioned.

MR. PURSELL: That would be terrific.

SENATOR INVERSO: Yes, to see what their position is on that, whether, indeed, this is construed to be a contract breaker or not. I think it is fair to get their position on that, if you feel they have not stated their position, at this point.

MR. PURSELL: They haven't. The March 17 letter, which was hand delivered to the Governor's Office, has not been responded to whatsoever.

SENATOR INVERSO: Well, we can ask, through our Committee, if they would consider and agree to responding to that. I think, in a sense of fairness, that they should.

Alan?

MR. KAUFMAN: For the record, our attorney is working with the attorneys from the other public employee unions currently drafting what will be filed as a joint unfair labor practice around the issue of the 2 percent, a unilateral unnegotiated reduction in wages.

Now, the Treasurer came up here and made a statement that no one really challenged, which was really sort of outrageous. He said that the gross pay was not being reduced by the 2 percent. So if you were making \$50,000 and you were going to get a 6 percent raise, you would go to \$53,000, and, notwithstanding the 2 percent, you would still go to \$53,000.

People do not live off of their gross pay. They don't pay their rent, buy their food, take their kids and buy them clothes, or do anything with their gross pay. It is the net pay. That is what you have to spend after everything is taken out. It was sort of amazing that the Treasurer posed it that way, because there will be in the paycheck, if the proposal goes through, a little 2 percent marker there that will be netted off of your gross pay.

SENATOR INVERSO: I think what he was saying-- The question is--

MR. KAUFMAN: No, he said gross. I heard him a couple of times.

SENATOR INVERSO: It is a question of definition, and he was correct. Gross pay is not going to be affected. Take-home pay, net pay, dollars in your pocket will be reduced by this proposal. I think we all understand that.

MR. KAUFMAN: Yes, but he didn't say that.

SENATOR INVERSO: Well, I think what he was saying was, this is not a pay cut.

MR. KAUFMAN: Pardon?

SENATOR INVERSO: A pay cut -- is what he said.

MR. KAUFMAN: Well, then it is doublespeak. It is a pay cut if you are taking 2 percent off your--

SENATOR INVERSO: Well, I am not speaking for the Treasurer, but it is clear to us all that if you are earning \$35,000 a year, you will still be earning \$35,000. If you were taking home, you know, \$23,000, you may be taking home \$22,650, or whatever the appropriate number is. I don't have the calculations right immediately, but we understand that. We understand that this is, as I have characterized it, a bread-and-butter issue relative to dollars in someone's pocket. We understand all that.

MR. KAUFMAN: Okay. The other issue -- and I guess the actuary will call very shortly -- is that the 2 percent is, in a sense, a separable issue, in that it doesn't go to the integrity and viability of the pension plan itself and its ability to pay off its obligations. It is just a cost shift from the employer to the employee.

But the comments that the Governor has made and the Treasurer has made about the fact that they haven't cut the benefit levels, is really a point that is off point, because the question people have to deal with is not whether or not

there was some technical, at this point, change in the formula to determine your pension when you retire, but whether or not the methodology and assumptions that are being used to fund the system will provide the adequate resources to pay the benefits when people are there.

So it is really way off point to talk about the fact that they haven't touched the benefit levels. The question really is whether or not what they are doing jeopardizes the system. Now, you really haven't heard from NJEA or the CWA actuary yet. You just heard the picture from the State's actuaries. So I think you will get a different picture when our actuary calls, and I am sure when the NJEA's actuary comes up here, about the viability of the system under these proposals.

MR. PURSELL: The other part about the 6 percent is troubling as well. That is taken out of context. We agreed to a 15-month wage freeze in the contract, expecting that the contract would be end-loaded and the 6 percent raise would be implemented this July. But there are many more employees whom we represent. In Hunterdon County, we have no contract right now. I believe in Hamilton Township we have no contract at this point. There will be a real reduction of 2 percent. The contract in Hamilton calls for a six-month wage freeze to begin with, so the problem will be that, even though some State workers are getting a 6 percent raise, the bulk of municipal workers are getting something significantly less than that. That is based on the wage freeze that we entered into back in '92.

SENATOR INVERSO: I guess we are waiting with bated breath for the call. We have about five minutes, I suspect. Do you have 11:55?

SENATOR KENNY: Almost 12:00.

SENATOR INVERSO: Almost 12:00?

SENATOR KENNY: Yes.

SENATOR INVERSO: Can you call, or is it going to be his nickel?

MR. PURSELL: Well, he told me-- We made it for exactly at 12:00.

SENATOR INVERSO: It's better if it is his nickel, instead of the State's nickel. This may be a long phone call.

MR. KAUFMAN: The Treasurer also testified about, you know, something to bolster the State's economy. I don't know who has seen their paycheck now that the income tax -- the 5 percent reduction-- I think it was \$1.50, or something, for the average person, which would allow you to buy the Sunday paper for the year, which may be good for The Star-Ledger or The Trenton Times, but it is hardly going to--

SENATOR INVERSO: Alan, I hear what you're saying. I know what you want to get out, but let's talk about the pension.

MR. KAUFMAN: Okay.

SENATOR INVERSO: You know, I try to be agreeable. I have to be, because you threaten me all the time, right, so I--

MR. KAUFMAN: It is part of what is driving this policy. I know it hasn't come from you, but it is very disconcerting to hear the bashing of public workers that is going on around this. It has been driven over this, because we are being pitted against the public. Somehow the woes, the fiscal woes of this State, are due to public workers and their benefits. It is very disconcerting. I want that message to get across. Really, it is unfair and it is wrong.

In terms of the pension system, you know, in the private sector, 96 percent of the people who are in defined benefit plans, like the ones the public employees are under in New Jersey, pay nothing toward their pension plan. If they see their paycheck, they see 7.65 percent taken out for unemployment benefits, and nothing for their pension. There are a couple of states -- notwithstanding the testimony of the Treasurer -- which do pay the full costs of employee pension

benefits, and in 25 percent of public sector plans across the nation, the employers pay the entire pension plan. The actual amount that is being paid in New Jersey-- The Treasurer said 4 percent; our actuary says it is more like 4.96 percent. That is probably on the high average of those plans where public employees contribute, as they do in New Jersey.

So public employees in New Jersey are hardly getting anything that is unfair, and they are paying their very fair share in the benefits they are receiving. In terms of health care, sick time, and all those types of things -- they are certainly things that were earned. The Treasurer also said something -- implied here, and implied when he testified before the Assembly Committee -- that somehow these pension benefits did not go for anything. I think people earn them, and the people who are retired are active and productive members of the community, too, and spend those pension dollars, which is good for the economy.

SENATOR INVERSO: Alan, I won't penalize you for not taking all your time, either. You don't have to just go on--

MR. KAUFMAN: All right. I am trying to fill in the time with what I hope are relevant comments.

SENATOR INVERSO: You don't have to. We can take a respite here. You know, we can relax. It will only be a minute or so.

MR. PURSELL: We could actually talk about Claude's credentials.

SENATOR INVERSO: Okay, yes. I read the material you gave me.

MR. PURSELL: Claude is a Fellow in the Society of Actuaries, which is a very honored position. I must note that, from our understanding, Mr. Baus is not a Fellow in the Society of Actuaries, not that that impugns his integrity, but there were actually some troublesome statements made in the State's analysis of the pension system reforms which our actuary

pointed out, specifically going from the 30- and 40-year amortization, which was mischaracterized by the State's actuary as being something that is acceptable. That is not how the statement was made, and it was taken out of context. I find that problematic.

SENATOR INVERSO: I don't want to get into the technicalities of it. What I read was that it is acceptable--

MR. PURSELL: Some people feel it is--

SENATOR INVERSO: --now under the -- I don't know if it is the Government Accounting Standards Board, or whatever board. They are looking to then cut that window down to 30 years. So in 10 years, 30 years would be the acceptable period. That is what I read somewhere.

Do you know how long Mr. Poulin will need to be on the phone with us?

MR. KAUFMAN: It would probably be a good idea to sort of get him hooked in here and sort of orient him. When I talked to him about this-- It is a little hard not to have heard what is going on in this sort of picture where you are. Just sort of get on the phone, start talking, and get him oriented.

SENATOR INVERSO: Well, that's why, you know--

MR. KAUFMAN: I told him that what you wanted was, you know, his comments on the plan, and then it would be open for questions.

SENATOR INVERSO: I don't know if this is a first.

UNIDENTIFIED MEMBER OF COMMITTEE: I believe it is a first.

SENATOR INVERSO: This is a first, so you are breaking new ground here. Apparently, a telecommunication on testimony--

SENATOR KENNY: Oh, really. We are going to be getting into the 20th century.

SENATOR LaROSSA: We could have simultaneous committee hearings, you know.

SENATOR CASEY: We shouldn't be rushing things.

SENATOR INVERSO: I thought we were going to have a videophone here, too, to make sure-- (phone rings at this point)

SENATOR KENNY: It works.

SENATOR LaROSSA: A free associated Committee hearing like the other one, two at once.

SENATOR INVERSO: Hello.

C L A U D E P O U L I N: This is Claude Poulin.

SENATOR INVERSO: Yes, this is Peter. Can you hear me?

MR. POULIN: Yes, I can hear you.

SENATOR INVERSO: Okay. This is Peter Inverso, Chairman of the Committee.

MR. POULIN: Yes, sir.

SENATOR INVERSO: We have in front of us Mr. Kaufman and Mr. Pursell, who have made some introductory comments, both inflammatory and noninflammatory. That is said tongue in cheek.

We have Committee members here around the table. I just want to make sure they can hear you. Could you please speak up. Say something like "Hello" and "Good-bye."

MR. POULIN: Yes. My name is Claude Poulin.

SENATOR INVERSO: Can everyone hear?

MR. KAUFMAN: Can they put the mike down near there, and maybe we'll get feedback.

SENATOR INVERSO: Okay. Hello.

MR. POULIN: Yes, can you hear me?

SENATOR INVERSO: Yes. Very good. Can everyone hear?
(affirmative response)

All right, Mr. Poulin. We are just going through some mechanics here. We will be with you in a second. Our resident -- what do they call you? I was going to say "entertainer," but I don't want to say that. (Chairman speaking to man moving microphone)

Mr. Poulin, we are here to hear your input today with regard to the State's pension proposals. Please proceed.

MR. POULIN: Well, Mr. Chairman and members of the Committee, first I would like to thank you for allowing me to testify this morning in this rather unusual manner.

My name is Claude Poulin. I am a Fellow of the Society of Actuaries, an Enrolled Actuary under ERISA, and I have been a consulting pension actuary for the last 25 years. I have been an actuarial trustee of the Connecticut State Employees' Retirement Commission since 1982. I was asked by the Communications Workers of America in New Jersey to review the various elements of the Governor's pension reform proposals and the testimonies made by several government officials in April, as well as the State actuary.

Before going into the specifics of the pension reform proposal, I would like to make two points. First of all, any discussion of pension reform should be based -- should be predicated on the actuarial axiom that the true costs of any pension plan are only represented by the benefits that will eventually be paid from the plan, with no reforms dealing with actuarial methods, assumptions, or procedures, when, in fact, these are only tools that affect the timing of the contributions. No reform dealing with these actuarial techniques will ever have the virtue of bringing permanent savings. So every dollar that is not paid today, will have to be paid later with interest. This is something that cannot be escaped. It is a little bit like a mortgage. If the actual payment should be \$800 and there is an agreement to pay only \$500 in the early years, then the difference will have to be made up in the future.

The second point is more specific to New Jersey. At the present time, some benefit has been recognized and some liabilities have been recognized by the system. I referred to the 60 percent of the pension liabilities related to the cost-of-living adjustments. These liabilities have only been partially recognized. The State has not even started paying

for them. This, in a way, violates a norm, or an extender that has been promulgated by the Actuarial Standards Board, the actuarial body that prescribes the various norms or extenders that have to be followed by pension actuaries.

Without getting into the details, it says that all provisions of a pension plan must be taken into account when you measure pension obligations. This is not done at the present time in New Jersey. I mean, not all liabilities-- Not all provisions of the plan are recognized.

I don't want to repeat the six elements of the pension reform proposal, because I am sure that by now all the members of your Committee are very familiar with them.

SENATOR INVERSO: We are very familiar with them, yes.

MR. POULIN: But let me converse on the funding method, or the actuarial cost method. At the present time, persons are using what is called the "Entry Age Normal Method," and the proposal is to switch to what is called the "Projected Unit Credit Method." The Entry Age Normal Method -- the current method -- provides employer contributions that tend to be stable as a percentage of payroll; whereas, the pension costs under the proposed method -- the Projected Unit Credit Method -- tend to increase over time.

There is no rationale, really, that has been in the vote for changing a method, except that there would be immediate cost reductions. But we have to recognize that these will be followed by substantial cost increases in the future. I don't know if New Jersey-- There has been a court case in New York -- in the New York State Court of Appeals. Actually, it came out recently against a state proposal to change from what was called the "Aggregate Funding Method" to this Projected Unit Credit Method that we are talking about here in New Jersey. For exactly that reason, by switching to this method, the legislation-- Now, I am citing from the Court of Appeals decision -- the judge's decision. It said that it

would allow the employers to deplete moneys in the existing pension fund by reducing the amount of employer contributions. Reserve moneys would not be available for immediate investment; the return on investment of moneys in the existing fund would be decreased; and the additional security provided by these moneys in the pension funds would be impaired.

The court also said that the legislature, even though it has some flexibility with respect to the administration of the fund, remains bound by the same fiduciary duties required of any other acting in a fiduciary capacity; that is, protecting the interests of the beneficiary. For that reason, it ruled against the state proposal to switch to Protected Unit Credit.

One final point with respect to this method -- to this proposal, is that the State has claimed that the pension costs would increase over time. But if the State were to switch to this Projected Unit Credit, then it would only compound the problem, because we expect that with the reduced contributions in the early years, then contributions would have to be made up in the future. They would have to be increased in the future, and it would just exacerbate the existing problem of increasing costs.

The second proposal that I would like to address myself to is the extension of the schedule. It is going to amortize the existing unfunded liabilities over a new 40-year period. As you know, at the present time, the schedule -- the infinite liabilities are funded over a 30-year period. This was done three years ago, approximately, so that now there are only 27 years remaining on this amortization schedule.

There is a proposal to amortize to over 40 years. First of all, it goes against the spirit of the Governmental Accounting Standards Board -- GASB. There was an exposure draft that came up earlier this spring which said that their proposal is really for a 30-year schedule. But it did

recognize the fact that some states would have a problem with 30-year funding, because they are, at the present time, at 40 years, or some are even less. In order to give them some latitude and a transition period to increase their contributions-- They do allow, for a transition period, the use of 40-year funding.

I refer here to a statement that was made by an actuary working for the State, which said the existing accounting maximum of 40 years had worked well for many years, and should be retained. I prepared a text -- I don't want to get into the full text -- of the Governmental Accounting Standards Board. It is clear from their context that what they meant was 30-year funding, but in some cases they would accept 40-year funding on a transition, or a temporary basis.

The statement had also been made that this was brought on by ERISA -- 40-year funding. I must say that this is an inaccurate statement. When ERISA was enacted in 1974, at that time it did-- It was a little bit similar to what is happening now with GASB. It did provide, for a temporary period, the amortization of existing liabilities at that time over 40 years, but it also provided that new liabilities created after the passage of ERISA would have to be funded over 30 years.

Moreover, the employers do not have the latitude to reamortize these liabilities over a new 30-year period. It is a little bit-- What is happening here is that at periodic intervals, some people would like to reamortize their mortgage, or refinance their mortgage. This is what is proposed here, so that a new 40-year period-- This is not acceptable under ERISA, and even a new 30-year period would not be acceptable under ERISA. Once a schedule has been adopted, it has to be followed.

The third point is the reduction and funding of the cost-of-living adjustments. As you know, Mr. Chairman, before 1987, cost-of-living adjustments were only funded on a

pay-as-you-go basis, which means that they were not funded at all. In 1987, a decision was made to fund them throughout the retirement system, and a schedule was adopted. In 1992, there was an acceleration in the recognition of these liabilities. I believe the schedule that was adopted at that time-- The numbers are all over the lot, because some applied to local employers, some applied to State employees, members of PERS, and there are different numbers for the teachers' plan.

But, in general, in 1994, under the current schedule, approximately 35 percent, or 34.5 percent of the liabilities are recognized for funding. In 1995, it would have been 40.5 percent for State and teachers. The proposal is to reduce this to 20 percent recognition in 1994, and 24 percent in 1995.

I believe that this is very dangerous, because this is setting the stage for eventually, perhaps, the elimination of the COLA. Also, it is like the point that I made earlier about the actuarial cost method. It shifts the burden of funding to future taxpayers, and it also departs from the actuarial practice -- the one that I discussed earlier about the Actuarial Standards Board -- of funding all pension liabilities provided by a pension plan. There is no real rationale for such a proposal. I think it would be a very dangerous course, especially-- As you know, last year, the percentage of funding -- the percentage of the liabilities that was recognized for funding purposes was also reduced.

There is a proposal that applies to the teachers' plan that would extend the phase-in period for recognizing devised actuarial assumptions. This does not apply to PERS. The only thing I would like to say about this is that, first of all, there is no rationale. Also, it is against the spirit of what I was saying earlier; that some liabilities are not recognized. We know, for instance, when we talk about the mortality table, or any other actuarial assumption, that if the mortality table is incorrect, or is in the case of a pension

plan, it overstates the mortality of individuals, of pensioners, and then it reduces-- It artificially reduces the present value or fee; the present, a lump sum value of these liabilities. Not to recognize this is in the same nature as reamortizing liabilities or ignoring liabilities, as is the case with the cost-of-living adjustment. It is for that reason that I believe this proposal should be rejected.

I have noted that the mortality table used for PERS -- the Public Employee Retirement System -- is an older table, a 1974 table, than for teachers. In the absence of--

First of all, I would like to backtrack a little bit. An older mortality table, in general, resolves an understanding of liabilities, because as longevity has increased over the 20th century, and as mortality rates have come down, the mortality tables have been adopted -- been adjusted regularly by the Society of Actuaries. An adult table for a pension plan is an indication that liabilities might be understated. Now, I have not done this study, and I understand that studies have not, in fact-- An actuarial investigation has not been done by the State actuary. But the point could be made that this extension of the period to recognize changes in actual assumptions should equally apply to PERS as it does to the teachers' fund.

The fifth proposal is the elimination of a 2 percent employee contribution reduction, which was into Social Security. This is not really an actuarial issue, but I have been a pension consultant for the last 25 years, and I note that there is no magic formula that dictates the level of employee contribution in the State retirement system, or in the private sector either. At the present time, in the private sector, 96 percent of participants do not contribute at all toward their defined benefit pension plan. In the public sector, 25 percent of participants do not contribute. For those who do contribute-- The actual percentage for regular

participants at the present time hovers around 5 percent. I believe that for the average New Jersey PERS participant, the contribution at the present time is around 5 percent. To increase this calculation from 5 percent to 7 percent would make State employees contribute a much larger share. That is the case for other public employees. Again, if we compared this to private plans, then it would be much above what the situation is in the private sector.

The sixth element of the reform -- which is not really an attention issue per se -- is related to health care. It is the elimination of the funding for post-retirement health care coverage. This is the element of the reform that would provide the largest immediate reduction in State contributions. I understand that the forecast was that there would be a reduction in contributions of \$268 million in 1994 alone.

What happened over the last five years in New Jersey was, I think, in light of policy. I understand that it was not a policy that was followed in other states -- that district funding -- and it was also only partial recognition of these liabilities. However, I believe it was going in the right direction, because these retiree health care costs will have to be paid at some point in the future. If not now, they will have to be paid in the future. The argument that was invoked-- The rationale-- There were two rationales, really, for this proposal. One was the uncertainty in Washington with respect to health care reform.

While there is, certainly, an uncertainty with respect to the nature and the components of any health care reform -- in fact, hearings started yesterday under Chairman -- Senator Kennedy of the Labor Committee -- it is obvious that there is a lot of confusion, but there is one thing that is certain; that is, there will be costs for retiree health care. These costs will not disappear. Usually, when they are faced with uncertainty, actuaries tend to be conservative, and they would

assume a worst-case scenario. So it is hard to understand here why, because of the uncertainty, we simply eliminate any form of prefunding. That is very hard to understand.

The second rationale that was invoked by the administration was that the rate of increase in medical care premiums has abated in the last few years. That might be true. I believe it was in 1993 that there was a reduction, in fact, in the medical care premiums. But again, it does not mean that there will not be any health care premiums to be paid in the future. I think a better point that should be made here, is that the Office of Legislative Services of the New Jersey Legislature said, last month in their comments on this proposal, and I quote: "A decrease in medical inflation is not usually accepted as a reason for adopting a pay-as-you-go methodology versus prefunding." I think what they really meant here was, the rationale, the interest note, just did not make sense, because it is not a reduction in rate that should lead to a total abandonment of prefunding.

So those are the points that I wanted to make before you, Mr. Chairman. There was one final thing that I would like to say, in general: One reason for these changes that the New Jersey PERS -- and my comments are for PERS, and not merely for the teachers' plan -- is that it was overfunded. But I must say that this is not a correct statement, or it would only be correct if we based the liabilities on the rate of interest that is 8.75 percent, which was assumed by the State actuary in order to compute the liabilities. A funded ratio is the ratio -- the assets in the pension fund -- to the present value of all the liabilities that would be paid in the future.

Now, if you value liabilities at the rate of 8.75 percent, as opposed, say, to 7.75 percent, you may reduce the lump sum, or you may reduce the present value of these liabilities by as much as 15 percent or 20 percent. This rate of 8.75 percent is really on the high side. A study was made

by the Government Finance Officers' Association two years ago. It was a survey of actuarial and investment practices of the State Employees' Retirement System. This survey revealed that 84 percent of the State Employees' Retirement System used an interest rate of less than 8.5 percent, and only 4 percent of State plans use an interest rate assumption exceeding 8.99 percent. So the rate used by New Jersey PERS, which is a rate dictated by the Treasurer of the State, is on the high side and tends to understate liability and, therefore, overstates the funded ratio.

If you look in the actuarial report prepared by the State actuary in 1993-- Instead of using this report, the actuary says that if, instead of using 8.5 percent, they were to use what they call the "Bump Forward Interest Rate Index," which is an internal rate of interest developed by the consultant firm, the New Jersey State actuary-- In 1993, PERS would have been only 75 percent funded for the State, and 77.8 percent for local employees. So this is not overfunded at all.

I would like, again, to thank you, Mr. Chairman, for allowing me to testify. I would be glad to take any questions, if you have any.

SENATOR INVERSO: Thank you, Mr. Poulin.

I have a couple of questions: With regard to your last comment about the ratio of assets in the fund to the, in essence, present value of the accrued liabilities--

MR. POULIN: Yes?

SENATOR INVERSO: --you hinged on the 8.75 percent rate, but isn't it true -- and I am not an actuary, please understand--

MR. POULIN: Sure.

SENATOR INVERSO: --I am a layman -- but having gone through this process somewhat two years ago and gotten my baptism of fire there, there are certain factors that have locked in my mind.

Isn't it true that it is not so much the interest rate that applies as much as the spread between the interest rate and the cost assumption progressions? So if you have an 8 3/4 interest rate, but you have a cost progression that is within a range of 2.5 percent, 2 percent, or something like that, as long as they remain in tandem, you know, you have not done anything by assuming a high interest rate without a correspondingly high cost, so that the spread has to be maintained?

MR. POULIN: Yes.

SENATOR INVERSO: You focused on the interest rate of 8.75 percent, but isn't it true that the cost has been within the spread of 2 percent or 2.5 percent? As long as they remain in tandem, the valuation should not be impacted because of the interest rate.

MR. POULIN: Well, when you look at the-- When you project benefits, it is right that the attention should be based on the spread between the interest rate assumption and the salary scale. But the spread in this case--

Number one, when we take a snapshot of the pension plan as to what would happen today if this pension plan were to be terminated, then we do not really look at the spread between future salary increases, because there will be no salary increases in the future. So in a situation similar to what the Pension Benefit Guarantee Corporation is looking at in Washington, you compute the premiums for the unfunded vested liabilities.

SENATOR INVERSO: Right, but doesn't that only apply to private companies that, in these instances, are not as guaranteed as the State's existence.

MR. POULIN: Yes. It does not apply to pension plans in the public sector.

SENATOR INVERSO: Right. So I am saying, is a snapshot valid? That's all. I mean, I am not disputing that

if you take a snapshot-- In the case of a governmental entity, is a snapshot really a valid comment?

MR. POULIN: Yes, but in order to overcome these, you know, disconsiderations, because the actual assumptions that are all over the lot, as you know, for public employee plans-- The Wilshire Associates in California took the liabilities and the assets based on a common measure, what they call a "common actuarial assumption." They came to the conclusion that the PERS would be-- I do not have those numbers before me, because I am not in my office, but I think the plan was approximately 85 percent funded under the common actuarial assumption. That would take into account the spread you are talking about.

Now, I would like to add that if you are right, you are absolutely right. When we project pension contributions, we must look at these two, but I have no indication that the spread is lower than it is in other states. In fact, I believe it is higher. So it could be that the salary scale assumption is less than what it should be -- I believe.

SENATOR INVERSO: Okay, but that was an issue put to rest, I guess, two years ago, when we went through the revaluation. I know there was attention directed to that spread by all concerned parties and, of course, that was accepted.

Let me ask you about the aspect of the 5 percent contribution rate that is, perhaps, average for other public sector pensions in other states. Isn't it really a comparison that we need to make as to the plans -- in terms of the benefits from the plans? Have you been able to judge whether there is comparability with regard to our benefits and, therefore, tie it into the contribution rate?

MR. POULIN: I did, partially. The New Jersey benefits are not the average. I believe the formula is--

SENATOR INVERSO: Okay. It is 1/60th times--

MR. POULIN: One-seventieth?

SENATOR INVERSO: One-sixtieth.

MR. POULIN: One sixtieth?

SENATOR INVERSO: Right, times--

MR. POULIN: This is less than 2 percent times years of service.

SENATOR INVERSO: Right.

MR. POULIN: The average is between 1.5 percent and 2 percent, and there are some state plans that go as high as 2.5 percent.

SENATOR INVERSO: Okay. So you have some data available that shows the contribution rate relative to the benefits in those states where the comparison has been made with New Jersey?

MR. POULIN: Yes.

SENATOR INVERSO: Okay, super.

I guess that is all I have at this point in time. I will ask the other members of the Committee if they have any questions for you. Okay?

MR. POULIN: Sure.

SENATOR INVERSO: Senator Kenny?

SENATOR KENNY: Good afternoon. Can you hear me, sir?

MR. POULIN: Yes, sir.

SENATOR KENNY: Okay.

One of our concerns is that the administration is adopting these policies which you describe -- and the Chairman has just gone over a number of the policies with you -- because it is in dire need of cash in our budget. Our concern, though we understand that, is whether or not the policies are being more driven in order to acquire cash than to adopt other policies that might be more reasonable, assuming, for the benefit of the administration, that perhaps we should be changing the way we do some of these things. I just assume that, you know, for the point of discussion, because I have

very little knowledge at all about any of this, or about how all of this is done.

My concern is-- For example, on the post-retirement medical benefits, rather than what the administration proposes to do, which is to scrap the prefunding entirely and take down the \$400 million in savings that has accumulated over the years to use it for current budget expenses -- which is a rather radical thing to do in order to get cash into this year's budget -- perhaps could they not have changed some of the assumptions around post-retirement medical expenses, such as the inflation rate, and we could fund it somewhat differently, with more efficiency to the State, without having to go so far as to scrap the whole thing and take all the money out of the present system and use it for current expenses?

MR. POULIN: That was precisely my point, sir. I think their position is that they are throwing out the baby with the bathwater, and that by changing the assumptions it would certainly be more reasonable than what they are doing at the present time.

I am also concerned by the real reason for this pension reform. It is not a pension reform that was based on actuarial investigation. It is a pension reform the purpose of which, as you said, is to raise cash. All of these elements would reduce employer contributions. We can, of course, discuss each one of these elements individually, as I did, but, as you know, when you compound them, the results are dramatic, because it would reduce the State contribution by nearly \$5 billion over the next -- between 1994 and 1998.

SENATOR INVERSO: Mr. Poulin, may I inject something here? That is a significant sum of money, and it can be very alarming as we throw it out there. But we have a defined benefit pension plan, an obligation to provide the benefits going, you know, for the retirees.

MR. POULIN: Yes.

SENATOR INVERSO: While that number may be a valid number in terms of the amount of dollars less that would go into the plan, actuarially the State will be obliged to provide for the present value of the liability going forward, would it not?

MR. POULIN: Absolutely, yes.

SENATOR INVERSO: So that is the point the administration is making. They do not need to overfund the plan; they do not need to take money out of today's taxpayers to the benefit of future taxpayers. I guess the term they look for, or the term that is used in actuarial parlance, is intergenerational equity here. They are saying that there would be overfunding today to the detriment of future taxpayers if this occurs.

MR. POULIN: I disagree.

SENATOR INVERSO: Maybe I am not fairly characterizing the position--

MR. POULIN: No, I think you are.

SENATOR INVERSO: --but I am trying to articulate it as I understand it. So there is no jeopardy to the benefits, or to the people who are participants in a plan today, because the State will have its ongoing obligation to fund those liabilities.

The question is the level of funding going into the plan. Is it necessary to be \$5 billion more over the next-- How many years did you say?

MR. POULIN: Over the next five years.

SENATOR INVERSO: Five years. Do we need to put a billion dollars more into our plan over the next five years? That is the question.

I'm sorry, Senator. I just wanted to interject that.

SENATOR KENNY: That's okay. I don't want, you know--

MR. POULIN: There are two points here: the jeopardy to current participants, and then the cost to future taxpayers.

The benefits we are talking about are benefits that already have been accrued by current employees -- that have been accrued 5, 10, 15, 20 years ago. These are not benefits that will benefit the taxpayers of the years 2015 and 2020.

The second point is: There is a disillusion that there is overfunding at the present time. This is absolutely incorrect. Under any actuarial guidance, under any law or the Government Accounting Spenders' Board, or ERISA compared to other plans, at the present time there is no overfunding. On the contrary, there is underfunding to the extent that already accrued cost-of-living adjustments for active employees-- These are cost-of-living adjustments that have accrued last year, 5 years ago, 15 years ago.

SENATOR INVERSO: Right.

MR. POULIN: They are not recognized now. So not only is there not any overfunding, but they are underfunding these liabilities.

SENATOR INVERSO: Are we atypical?

MR. POULIN: Yes, absolutely.

SENATOR INVERSO: In other words, you're saying that every other state, with regard to its pension plan, is fully funded at this point in time?

MR. POULIN: Well, maybe not--

SENATOR INVERSO: That is not what you're saying?

MR. POULIN: --every other state, but when there are cost-of-living adjustments, they are recognized. They are part of the liabilities, and they are funded.

SENATOR INVERSO: Right, but we are recognizing a liability for cost of living, and we are achieving a schedule that would get us to full funding in -- I forget what year it is.

What I am saying is, do other states do anything differently? They do not fund 100 percent at this point in time, do they?

MR. POULIN: Yes, they do.

SENATOR INVERSO: They do?

MR. POULIN: Because there are two concepts here: One, if there is recognition of the liability--

SENATOR INVERSO: Right.

MR. POULIN: --and two, once this liability has been recognized, then it starts being funded over either a 30-year period or a 40-year period.

SENATOR INVERSO: Right, right. You are saying that every other state is fully funded, and we are not?

MR. POULIN: Well, they are not fully funded to the extent that they have finished the 30-year or 40-year schedule--

SENATOR INVERSO: Right.

MR. POULIN: --but they do recognize their liabilities.

SENATOR INVERSO: But, we are, too. It is a question of--

MR. POULIN: In New Jersey, you are not. You are only recognizing if you have 34.5 percent of liabilities, and 65.5 percent are ignored.

SENATOR INVERSO: Right. But the funding methodology to get us to a point of -- was it 60 percent? (no response) You are saying that other states will fund up to 100 percent.

MR. POULIN: Well, they recognize all of the liabilities, and they are under an amortization schedule. What is happening in New Jersey, though, is a little bit like-- Say you have a mortgage on a house, but you also purchased a garage. At the present time, you are on a 30-year mortgage for the house.

SENATOR INVERSO: Right.

MR. POULIN: But you don't fund anything for the garage -- anything. So, next year, you will recognize a

portion of the garage, and then you will reamortize this portion for a new 30-year or 40-year period.

See, at the present time, some of the liabilities are not even considered in the equation.

SENATOR INVERSO: Are you saying -- so I understand, again -- that New Jersey is unique in this regard?

MR. POULIN: To my knowledge, yes, but there might be other states that-- To my knowledge, yes. To have some liabilities that are not recognized is very unusual.

SENATOR INVERSO: Okay. Thank you, Mr. Poulin.

SENATOR KENNY: Are there other questions for Mr. Poulin?

SENATOR INVERSO: Do you have any more?

SENATOR KENNY: I have one other, yes.

SENATOR INVERSO: Okay, go ahead.

SENATOR KENNY: I just want to follow up. I don't want to use Mr. Poulin's presence here to make a final point, since there are other people who will be following me.

MR. POULIN: I can hardly hear you, sir. I'm sorry.

SENATOR KENNY: Okay. I am just making a concluding point in response to Chairman Inverso's questioning of you. I think, so everyone understands, that our concern is, first of all, whether or not what we are doing in funding the pension systems in this State is fiscally proper; and secondly, whether, when we move off the way we are doing now, we are going to put our fiscal house in disarray.

The question has already been raised by the bond rating houses that that is a concern to them.

MR. POULIN: Yes.

SENATOR KENNY: My concern, to the Treasurer, when he was here earlier, was: Are there other, more measured responses to their needs than the ones they are proposing? I think the proof is in the demonstration here today on their

chart. The reason I think the chart is very telling is because they actually did not tell us, in their presentation, that their post-retirement medical benefit contributions' schedule is based on a 12 percent inflation rate versus their inflation rate of 6 percent. So they do not come in with the 6 percent rate, which betrays the motivations behind all of these reforms, which is that they need maximum care. The way they max out is by doing this.

The reason why that is important is not just for this discussion here today, but for all benefits in the future which are going to be judged not by the issue, but by where they can get cash. That is why I am saying that the policies in this budget are being driven by cash needs.

Now, I do not think it is rhetorical or political to say that. I think it is something we have to understand: why the administration is doing what they are doing. If people want to vote for it, so be it. But that is the reason. I think we ought to be honest enough to say that that is the reason, and that all of these other things are really not the point. If they were being honest, they would come in and say, "Let's do this, let's do that. Let's bring people to the table and make the adjustment. We will save some money," etc. That is not what is being done here. They have adopted a very aggressive cash-making operation, which is really what this is all about. That is why I made the point this morning. I was not trying to be partisan; I was trying to-- You know, I had the Treasurer here and I had to address it.

SENATOR INVERSO: Right.

Are there any more questions for Mr. Poulin? Senator Casey?

SENATOR CASEY: Mr. Poulin, can you hear me?

MR. POULIN: Yes.

SENATOR CASEY: This is Senator Casey. Sir, on some of the charts we saw earlier through the Treasurer's Office--

MR. POULIN: I'm sorry. I think the microphone is picking up some other conversations.

SENATOR INVERSO: Yes. Can you hold it down, gentlemen?

SENATOR CASEY: I said, in some of the charts we saw earlier, they seem to all stop at the year 2006.

MR. POULIN: Yes.

SENATOR CASEY: I guess one question I have for equality is: If the change is adopted, the employers as a group, you know, will pay money into the system. Right now, I believe it is an example in Burke. That would be \$314 million, and employees will pay \$27 million. The employer--

MR. POULIN: Yes.

SENATOR CASEY: Are there any long-term range projects that say when this will become equal? When exactly would the employer pay as much as the employee? I think our charts here fail to show that. I was just wondering if you did any analysis on this.

MR. POULIN: Well, I believe that the \$27 million versus the \$300-and-some million lasts for 1992. Isn't that the case? (no response) This was because in 1992, there was another pension reform where the State appropriated some money that was already -- that had already been paid. I believe it was attributable to the return of employer contributions.

SENATOR CASEY: I guess, sir, my question -- maybe I didn't phrase it correctly -- was: Are there any charts--

MR. POULIN: Where will the line intersect?

SENATOR CASEY: That is exactly right, in what year?

MR. POULIN: I do not know that, but what I do know is that the State contribution should probably be, at the present time, much in excess of what the employees are paying -- the \$300 million that the employees are paying. It should be more -- \$500 million or \$600 million -- at the present time. If you

reduce it further, in the future instead of being \$800 million, it will be \$1.5 billion.

Let's assume that these proposals are adopted, the State drastically reduces its contribution, and everything else remains constant. Then, if you lower the State contribution at the present time, it will-- There will be dramatic increases by the year 2005, 2010, 2015. It would be unbearable.

SENATOR CASEY: Okay, thank you, sir.

Two other questions. I guess in your presentation here, on page 4--

MR. POULIN: Yes?

SENATOR CASEY: --you show the "Entry Age Normal" and the "Projected Unit Credit."

MR. POULIN: Yes?

SENATOR CASEY: Again, I appreciate this chart, because what I see in front of us today only seems to go up to the year 2006. It shows your projection. I guess you go up to the year 2030. Is that correct? Am I reading it correctly? Let me see.

MR. POULIN: Well, this is an illustration. It does not show--

SENATOR CASEY: Oh, I know, but--

MR. POULIN: It does not--

SENATOR CASEY: But the 30 means--

MR. POULIN: Think of all the situations here, but it shows that if we are-- Let's say at the present time we would be in the fifth year. Then the entry, if normal, would result in a reduction in contributions that would have to be made up starting 10 years from now, at the 15th year.

SENATOR CASEY: Okay, that is the 15th year from today. That is not the year 2015.

MR. POULIN: No. It could be 2005, 2008.

SENATOR CASEY: Yes, 2005. Okay.

MR. POULIN: But at one point in the future, then the contributions (indiscernible) would be much higher--

SENATOR CASEY: Okay.

MR. POULIN: --than they would be under the current system.

SENATOR CASEY: Then it starts rising. Okay, I see that.

One other question, sir: On page 14, you say, "In his testimony, State Treasurer Brian Clymer" -- and you go into five different points. Then you go into your statement, and the statement reads--

MR. POULIN: Which paragraph, sir?

SENATOR CASEY: Page 14, at the bottom.

MR. POULIN: At the bottom, yes.

SENATOR CASEY: After you mention the five points, you say: "These statements are highly misleading," strong words which I think, after what I have seen today, may be true. Since the State contribution in the current year will be drastically reduced, it will follow that the assets in the pension plan will also be reduced.

Now, I want you to explain to me, although I think I know--

MR. POULIN: Sir, I'm sorry. You said page 14. Which paragraph is it?

SENATOR INVERSO: It's the last paragraph.

SENATOR CASEY: Right at the bottom.

MR. POULIN: These statements are highly misleading, yes.

SENATOR CASEY: Now, in the second sentence of that paragraph, where it says, "The assets in the pension funds will also be reduced"-- Do you see that, sir?

MR. POULIN: Yes.

SENATOR CASEY: Okay. Now, explain to me just how you are saying, "The assets will be reduced." Is that using the

cash in that plan to pay the budget this year, next year, and the next couple of years?

MR. POULIN: Well, the assets will be reduced because contributions will be reduced.

SENATOR CASEY: Okay. So just by the contributions--

MR. POULIN: Also because some contributions that have already been made will come out of the pension fund; mainly, the contributions toward the post-retirement health care funding. So the assets would be reduced in 1995, compared to what would have happened had there been no pension reform proposals.

SENATOR CASEY: Thank you.

SENATOR INVERSO: We have one more questioner for you, Mr. Poulin. Senator LaRossa?

SENATOR LaROSSA: Mr. Poulin, good morning -- afternoon, I'm sorry.

MR. POULIN: Good afternoon.

SENATOR INVERSO: Unless you're in California.

SENATOR LaROSSA: The time has gone so rapidly.

Just two points: You made one statement in your commentary about ERISA not allowing a private pension plan to reamortize the unemployment liabilities over 40 years.

MR. POULIN: Yes.

SENATOR LaROSSA: Does ERISA say anything with respect to public pension plans?

MR. POULIN: It does not.

SENATOR LaROSSA: So it is silent on that issue?

MR. POULIN: That's right. It applies to private pension plans.

SENATOR LaROSSA: The other question I have-- I am assuming that you-- Actually, I don't know that I should assume this, but have you seen-- Scratch that.

I am assuming that you have a fairly good grasp of the total liabilities and assets, you know, today, in order to make

these kinds of commentaries as they relate to the State pension system. This is really a crystal ball question: Based on the -- I will use the equity in the system, that being the difference between what is needed to pay off benefits today versus what is left over which can continue to be reinvested, and contributions being made on an annual basis--

Do you have any idea-- This is not necessarily where the lines cross. This is a matter of where, in the future, is it possible that the system could potentially run out of money because of, you know, any reduction? The question is based on the fact that if we have a system which-- I have not heard a lot of disputing of the number of approximately \$36 billion. How solvent is a fund of that magnitude, and what kind of revenues can a fund of that magnitude generate on its own, in addition to ongoing contributions, to the extent that it becomes, you know, self-supporting or self-sustaining?

That is a long question, but please see if you can handle all of it, if you would.

MR. POULIN: Well, at the present time-- Let's assume that the system is between 80 percent and 85 percent funded. Then it would take a long time before the fund would be totally insolvent, as you say. But what would happen, is that in order to provide the benefits which have already accrued, there would have to be-- In order to make sure that these pension benefits would be paid, there would have to be dramatic increases in contributions in the future. When I say "dramatic," I am talking about 25 percent, 30 percent, 40 percent of payroll, which is the case in some states where, because of the lack of funding in prior years, they are-- In fact, there are some pension plans right now, where I am in Connecticut, where the state has to pay in excess of 40 percent, because of the negligence of the past.

Now, this is the second point. Your first point was with respect to ERISA. I agree with you that the theory itself

does not apply to government plans. But the point was made that the pension reform proposal would meet the ERISA requirements with respect to funding. I was just responding to these points, in that they do not meet the ERISA requirements, because in the private sector you cannot reamortize liabilities over 40 years, or even 30 years. You know, once you have a schedule, then these benefits have to be funded. The contributions have to be made, and there are penalties if they are not made.

SENATOR LaROSSA: Okay.

Let me try to rephrase one part of the question. I understand your last response. With that, as it relates to when does the fund run out of money, have you done any number crunching to, you know, come up with any kind of a-- You said that obviously it would be very difficult for it to become insolvent, because, obviously, there are laws which trigger what contributions have to be put in.

But, based on this -- on the characterization of it being underfunded -- how far into the future would you see these kinds of significant additional contributions needing to be made?

I will ask you the same question I asked the Treasurer and the other actuaries this morning: Do you have any suggestion or recommendation, specifically, other than the obvious, in terms of a guarantee -- realizing that there aren't any -- as to how you maintain the solvency of a system of this magnitude?

MR. POULIN: With respect to the first parts of your question--

SENATOR LaROSSA: Yes?

MR. POULIN: We have not made any studies as to when the fund would be insolvent if these proposals were adopted. But then in the second part-- I do not believe the State

actuary has made these calculations because, in fact, this is not the type of calculation that an actuary would be asked to do.

What would happen if there would be an absence of contributions, or when would the fund run out of money? It is not like the-- It simply is not made.

Now, what is the recommendation? The recommendation is something, in fact, that looks like ERISA. ERISA was a compromise. They talked about 30-year funding. They also left the choice of the actuarial assumption. The actuarial assumption had to be reasonable. It was not dictated from outside. ERISA also requires the actuary to recognize all pension liabilities, but only some portions of them.

So that would be my recommendation of what would be reasonable. It would be something similar to ERISA, but if that were the case, then the current contribution would have to be increased perhaps by 25 percent or 30 percent, just to meet the ERISA minimum funding requirements. What we are talking about here is a further reduction in State contributions. So at the present time, you know, the recommendation I am talking about is not even met by the states.

SENATOR LaROSSA: Let me just rephrase this one question then. We are talking about ERISA, private plans versus public plans, and so on. In looking at the different states, and from what I am hearing this morning, some states prefund things, other states do not. Sometimes they get to a point where they have to go to prefunding, and so on.

Am I correct in assuming, or in what I am hearing you say, that there is a standard -- for lack of a better choice of words -- for private plans, but for all intents and purposes, when it comes to government pension plans, there really is no standard rule of thumb -- no standard criteria as there is for private plans? Is that an accurate statement?

MR. POULIN: Yes, it is an accurate statement. There is no PERISA -- Public Employee Retirement and Top Security Act -- that would provide for some funding standards for public employee plans. You're right. It does not exist.

SENATOR LaROSSA: I am assuming that you would suggest that, at least on a national basis, if not certainly in New Jersey, would go a long way toward probably ameliorating a lot of the, you know, points of concern.

MR. POULIN: Well, as you know, a lot of people are talking about this very thing. They would like to have funding standards when it comes to public employee plans. I happen to live in Washington. Again, in Washington, the Mayor came out last month with a reduction of \$265 million in state -- in this case, district contributions, in order to meet the budgetary pressures -- in order to meet the budget.

What PERISA would do would be to prevent this arbitrariness and use fund money to solve budgetary problems.

SENATOR LaROSSA: Mr. Poulin, thank you very much for some real good clarification for my benefit.

Mr. Chairman, thank you for the opportunity.

SENATOR INVERSO: I think that's it, Mr. Poulin.

MR. POULIN: Thank you very much for allowing me to testify.

SENATOR INVERSO: Well, we thank you very much for your input. I think it has been very good. It has given us some food for thought, certainly. I'm glad it was your nickel, because it has been an hour.

MR. POULIN: Oh, okay. Thank you very much, gentlemen.

SENATOR INVERSO: Okay, thank you, sir. Good-bye now.

MR. POULIN: Good-bye.

MR. PURSELL: Where should we send this bill, Peter?

SENATOR INVERSO: You won't have to raise the dues, will you?

Well, we thank you very much. It was very good. I think you gave us some good insights into things. Some of the things that need it, we will try to get clarification on. I will confer with you, at some point, as to whom you would like to -- maybe it will be Mr. Poulin, I don't know who would be more appropriate -- come to this roundtable that we are going to pull together. I think it is important that all of this that has been put out today be given some give and take dialogue with the administration. To the extent that the members of this Committee wish to be there-- I don't know whether-- It is technical, but at some point I think I have to sit down with the group, whether it is that day, or some day after that, to see where we will go.

So thank you very, very much. We will look forward to-- I would like to ask for this meeting to be held a week from Monday. Just docket your schedules for a week from Monday, okay? Time and place we will sort out between now and tomorrow afternoon.

UNIDENTIFIED SPEAKER FROM AUDIENCE: That's Memorial Day.

SENATOR INVERSO: Oh, that's Memorial Day. I'm sorry, okay. Then we will make it Tuesday. Is the Senate scheduled for that day? I don't have my calendar here. (no response)

MR. KAUFMAN: We appreciate your efforts in providing a forum for this discussion. It is to your credit. Thank you.

SENATOR INVERSO: Thank you. We appreciate it.

Does anyone need to have a five-minute break before we go to the NJEA?

SENATOR CASEY: That would be kind of nice.

SENATOR INVERSO: Will we get everyone back if we take a break for five minutes? (inaudible response) Why don't we go straight through, then?

Dennis Testa and Chris Bone.

Excuse me, may I have quiet in the room, please? Okay, Mr. Testa.

D E N N I S T E S T A: Thank you, Mr. Chairman and Committee members for the opportunity to testify today. I am very pleased to speak to you on behalf of the 144,000 active and retired members of the New Jersey Education Association.

Before I begin my formal testimony, I want to address comments made by the State Treasurer yesterday to a joint hearing of the Legislative Appropriations Committees. Rather than discuss, and thereby dignify those remarks, I call your attention to a news release attached to our written testimony. I have attached it for your review at a later time.

I would also like to thank the Chairman for his attempt to foster a line of communications among this Committee, the administration, and the parties whom these pension changes affect. We have not, to this date, been able to have such a meeting with the administration. Our only contact came the day before the Governor gave her Budget Address. We were informed, at that time, what would be included in the Address, but the dialogue concerning that was extremely limited.

In addition, we have had a very difficult time getting data, information, and numbers from the Treasurer's Office so we can do proper analysis of the changes in the plan. Some have come and some haven't, but it has always been like pulling teeth to get the information out of the Treasurer's Office. So this is great. We appreciate it.

Our opposition to these changes is based on dire warnings from two top independent actuaries -- warnings echoed by two top bond credit rating firms. One of those actuaries is with me today. Mr. Chris Bone is Chief Actuary with Actuarial Sciences Associates. He is a Fellow of the Society of Actuaries, an Enrolled Actuary under ERISA, and a member of the American Academy of Actuaries.

NJEA has four major concerns about the proposed changes, which I will outline briefly. Then Mr. Bone will

present the information and technical analysis that support our positions.

We appreciate the opportunity to present this analysis. Our actuary's analysis stands in conflict with assertions made by the Governor and the State Treasurer. We are confident that when you have heard Mr. Bone's information, you will be in a better position to decide whether the changes proposed are harmful or not.

1) Our first concern is the proposed underfunding of the State pension fund. The Governor has proposed drastically reducing the employers' contribution to the fund. According to the nonpartisan Office of Legislative Services, she would slash the employers' contributions to the Teacher's Pension and Annuity Fund -- TPAF -- for Fiscal Year 1995 from \$584 million to just \$54 million, and in the Public Employees' Retirement System -- PERS -- from \$199 million to just \$3 million.

Just two years ago, NJEA agreed to a safe and reasonable pension revaluation. The Legislature -- in the revaluation law itself -- created a repayment schedule ensuring the safety of the pension system for future generations. The Governor's proposal reneges on that payment schedule in its very first year.

2) Our second concern is the proposal to abandon the prudent practice of prefunding the health benefits plan for retirees and switch to a "pay-as-you-go" plan. This not only ignores the requirements in current law, but it also places the burden of health care funding on the members of the Appropriations Committees each year. We believe paying post-retirement medical costs on a pay-as-you-go basis threatens the stability of the plan.

3) Our third concern is one not discussed previously, and it uses the so-called surplus from the State Health Benefits Plan to supply \$145 million in State aid to education. Next year, districts that participate in the State

Health Benefits Plan would be penalized by getting less State aid and some of their own moneys back.

On the other hand, districts in private plans that also have a surplus could get a rebate and they would still maintain their State aid. This provides a strong incentive for districts to leave the State plan, and thus presents a serious threat to an excellent system for the sake of maintaining a stable State Health Benefits Plan. This is the wrong message to give school districts, and it is grossly unfair to participating school systems.

4) Finally, we are concerned that the Whitman plan would shift an additional 2 percent of pension costs to school employees. According to the Office of Legislative Services, members of TPAF pay an average of 4.64 percent of their salary in pension contributions, and PERS members pay an average of 5.01 percent.

According to a 1992 study by the Bureau of Labor Statistics of the United States Department of Labor, 25 percent of government pension plans have no employee contributions. In the private sector, only 4 percent of medium and large defined benefit pension plans have an employee contribution. We vigorously object that school employees would be asked to pay 2 percent less next year.

Now I present Mr. Bone, for some of the backup data.
Chris.

C H R I S T O P H E R M. B O N E: Okay. Can you hear me?
(affirmative response from members of Committee)

What I would like to do, if I might, Mr. Chairman, is preface my remarks by explaining briefly how we got here.

SENATOR INVERSO: Excuse me. May we have a little more quiet in the room, please? We are getting distracted up here. Thank you.

MR. BONE: What I would like to do is to preface my written testimony with a brief description of how ASA initially

got involved in this process, because many of the issues that came up in this little historical summary are issues that have come up in the questions.

ASA first got involved in looking at the State employee pension system in 1989. In 1989, ASA and Buck Consultants, the State actuary for the TPAF and PERS, were hired by the State, under the Kean administration, to look at the issues of setting pension funding policy for the State: to explore the issues, to debate the issues, to find areas of common ground, and to explore areas of difference.

In the 1989 study -- and both the Florio and the Whitman administrations have referred to us as two nationally recognized actuarial firms which have come out of hiding and have pointed out who they are-- In that study, the key issues were issues of benefits security and intergenerational equity. As a result of the study, both consulting firms proposed mock model funding proposals. The ASA proposal was for a lower contribution than was the Buck proposal. Both of them were at a level between 5 percent and 10 percent of pay on a long-term basis. Once again, certain items were left out of that proposal; certain items were not left out of that proposal. But the key considerations were intergenerational equity and benefit security. I would like to first talk a little about those two key issues which have come up so much in the hearing already.

First, the issue of intergenerational equity: When you look at intergenerational equity, the issue is one of, "What services do taxpayers receive, and when do they pay for those services?" There are a number of different ways to measure when those services are rendered, which reflect the allocation of costs to different periods of time. This sounds very obtuse. I know I am the fourth actuary out of four, and you are probably tired of the abstractions, so I will try to be a little more practical.

Under the current method in the law, the State, ideally, looks at the cost of benefits that are earned in a year, and pays for them as a level percent of pay. So it is saying, "Over the long-term career of an employee, take that employee's total benefits, and pay for those total benefits as a level percentage of that person's pay." Under the method proposed by the State, the obligation would be measured on the projected benefit obligation method. The difference between the entry age normal method and the projected benefit obligation method is whether or not you reflect how old an individual is when you charge the taxpayers for his or her benefits.

Under the entry age normal method, you say, "We will make the contribution level as a percent of pay." Under the projected benefit method, you still reflect that those people will earn salaries, because their final benefit will be based on their final average salary. So you still reflect, in calculating generational equity, what it is that those people will earn near retirement, and attribute that to this year of service, because that is what your commitment is to those employees. But you say, "If someone is 25 years from retirement, I will call it cheaper to purchase their benefit than if they are 45 years from retirement, based solely on how long I have for the money to accumulate."

Those two different theories come up with different fund accumulations, etc., but they are merely two different ways of looking at it. In the past, historically, it has been viewed more appropriately by systems throughout the country to look at the costs on a level percent-of-pay basis, to say, "We are paying these people over a certain period, and we should keep the costs of their services relatively level as a percentage of pay." This new change, which has been reflected by a few, but not very many state systems, would be a change from the historical precedent, both in terms of government

looking at how benefits are accrued, and how state regulators look at how benefits are accrued in private plans.

The other issue I would like to talk about briefly -- and I am sorry for going on for so long without anything for you to look at -- is the issue of benefit security. You have heard a lot today about the ratio of the accrued benefit obligation to the assets as a definition of benefit security, but there are two significant definitions of benefit security. One is whether, if I terminate the plan today, I have enough money to pay for the current benefits under the plan. When you look at those sorts of measures in the private sector, you say, "Could I give that obligation to someone else?" That is the measure which is looked at when financial accounting numbers are talked about in the press. For instance, when you hear about General Motors' underfunded pension plan, the number they are looking at is the current promises accrued to date versus the assets accrued to date.

But there is another very significant factor in benefit security, which is: If I, as an employee, am told, "This is the program of benefits," has the employer put enough money aside so they will be able to continue that program of benefits until the point when I retire? I think that is a key consideration in benefit security. It was certainly a key issue in looking at these issues in 1989:

- 1) Do you have enough money to terminate? and
- 2) Have you put enough money aside to stabilize contributions over time?.

Now, that second one, of course, clearly links back into the whole issue of generational equity, since presumably if you are maintaining generational equity, you are putting aside the money as it happens, and you won't have to worry about reaching back and picking up these money for crude benefits in the past.

But if in generational equity you are looking at the true structure of the plan, you should have put away more than the accrued benefits, unless you are depending on future taxpayers to pick up the increase in benefits due to salary increases which were communicated to employees as part of their benefit, when that benefit was earned.

So, if I may, I would now like to--

SENATOR INVERSO: Well, on that latter point -- if I may inject -- isn't that appropriate measurement? I mean, if the salary increases are coming in the future, shouldn't the additive costs for those increases be borne by future -- in the cases of public entities -- taxpayers?

MR. BONE: I don't think so, because, as a matter of fact, employees have a typical expectation of salary increases tied to a real rate of return, a real benefit. That is certainly not an approach that has been adopted by any accounting body. For instance, in the private sector, financial accounting standards, the expense that a company recognizes is based on projected obligations which include the projection of salary increases. It has been communicated to the employees as part of their benefit.

SENATOR INVERSO: But that is part of the--

MR. BONE: For GASB as well. I'm sorry.

SENATOR INVERSO: Is that part of the variables in the plan -- the salary progression? That is part of the determination of what your accrued obligation is at any point in time?

MR. BONE: Not under the one measure that they were citing.

One of the things I would also like to get into is, there are-- Actuaries throw a lot of numbers around, and sometimes use terms which are distressingly similar. For instance, there is the accrued benefit obligation and the accrued actuarial liability, which are two very different

numbers. In the accrued benefit obligation, there is no projection of future salaries. It is what is called the "projected benefit obligation," which still does not recognize future years of service -- that future salaries are reflected.

What I would like to do is go back, for those of you who are trying to follow along with my written comments--

SENATOR INVERSO: We are getting weary -- I can assure you of that -- but we are trying hard.

MR. BONE: Well--

SENATOR INVERSO: I did not mean to--

MR. BONE: --actuaries hide behind a screen of numbers. There is a reason, as a matter of fact, for the actuarial profession's noted reputation for, shall we say, long diction and rolling periods. That is because-- As an actuary, I spent my professional career focused on money, death, and sex, and I have to hide it somehow. Unfortunately, it is about in that order.

So, moving on to the paragraph under "Issues," what I have done here is to break it up into what I think are the policy issues, and then, also, to go into some of the clarifications as to where numbers are being used in a way which presents a one-sided case, where we think there is really a two-sided case.

The first issue, as Dennis mentioned, is the deferral of costs. We have not done a full-fledged valuation. We have been dependent, as was Claude Poulin, on the numbers prepared by the State's actuary. We have looked at the numbers we received briefly to see if they are reasonable and we did some further estimates from them, on the basis that we could estimate closest to the numbers we initially got. In each of the next 12 years, the new proposal would not set aside enough funds to cover the costs of benefits earned for those years of service, recognizing the future pay. Now, that is only looking

at the pension side. Of course, on the retiree medical side, we are not setting aside money at all.

As an analogy, I think you can say, "Let's look at this as a credit card." Based on the projections we did, the State is not paying off the current purchases of services that are being rewarded by future pensions for the next 12 years or so; and over the entire 20-year period that we looked at, the State is not paying off the interest on the prior purchases, plus the current purchases themselves on a PBO basis.

When you look at retiree medical benefits, the situation gets even worse in a intergenerational equity point of view. The State will be coasting for two years on contributions which began during the Kean administration. This coasting, as we discussed in the 1989 study, does not meet the criteria the State's actuary set up. The State looked at a couple of different criteria. One was the accrued benefit obligation; another was maintaining a level of at least "X" years' worth of benefit payments. This only meets that criteria if you said "X" equals a zero. So there is concern over whether, under the proposal, you are setting up a system under which costs will grow to a point where future benefits are cut back.

The next item I would like to look at is the employee contribution increase. Once again, this is based on numbers provided by the State's actuary. During Fiscal Year 1995, employee contributions to the TPAF -- which is the system we were looking at -- would be a little bit over \$300 million. The State contribution would be \$54 million, so for Fiscal Year 1995, the State would be asking teachers to contribute at a rate of six times the level that the State would be contributing, based on some initial numbers that the State's actuary had given us. I am not clear exactly how those numbers correspond to the numbers they discussed this morning. I will get into that later. But, based on the initial projections

that they gave us, which were embedded in their prior testimony, the teachers will pay more than the State through about the year 2007.

Now, actually, based on the numbers we have done, we think the teachers will pay more than the State only up to some earlier point, probably 2003 to 2005. We do not have great numbers on that. The reason for that is that we think the numbers that project the proposed plan are likely to be understated, at least the numbers we have seen so far. It is not clear whether these are new numbers or not.

The next item I would like to go into is the usefulness of the numbers. The initial set of projections that the NJEA was given by the State Treasurer were clearly erroneous. They overstated the cost of current law. After the year 2006, it grew at a rate of about one and a half to two times the rate it should have.

Now, the question may be, "How can you tell?" I hate to use the actuarial trump card, but under the State's current funding method, costs are scheduled to be level or decrease as a percentage of pay, and the only thing that interrupts that progression is that we are not recognizing all the costs in a particular year. Under the current law proposal, costs are phased in until the year 2006. After 2006, costs should be level or decreasing as a percent of pay. The initial numbers we received were going up at 9.5 percent, when pay was estimated to be going up at 6 percent.

We have received a second set of numbers. In that second set of numbers, no changes were made to the projections of the proposed bill. Some changes were made to the projections of current law, but it continues to fail the test that contributions should be going up at a pace equal to, or less than the pace of salary scale increase.

In this morning's testimony, it appeared that they had done some further projections. They indicated to us that they

would be doing some further projections. We have not yet been given them to review.

SENATOR INVERSO: Let me inject here. I was going to inject when Mr. Poulin commented, too. I have spoken with the Treasurer's Office. They, apparently, have had work done on those projections. I expect we can have those numbers, hopefully, prior to the meeting a week from Tuesday. So that information will be available. They said they were working on those detailed studies. You should have an opportunity to take a look at those, and to comment on those when we get together.

MR. BONE: It would be very useful. There was some confusion initially because the one set of numbers that the NJEA received from the Treasurer was not the set that the State's actuary was looking at, when we called them up to discuss their numbers.

What I would like to do next is to go to the "Clarifications" section, and then come back to this item on "Implications of Deferring State Contributions." In the Treasurer's testimony today, he said that the 2 percent subsidy was "almost" unique to the State of New Jersey. In his prior testimony, he said that it "was" unique to the State of New Jersey. In fact, there is a study by Workplace Economics, Inc., which I have here, for 1994, which shows that the States of Illinois and Oregon pick up the entire costs of employee contributions, and that the State of Wisconsin pays the first 6 percent of salary -- of employee contributions. This study also summarized the benefit formulas under the various plans it had surveyed. Glancing at it briefly, it would appear to answer another question you had as to the level of employee contributions versus the benefit formula. Most of the benefit formulas they are surveying provide benefits which are higher than those under the current New Jersey plans.

SENATOR INVERSO: Let me ask you a question: The Workplace Economics, Inc. study-- Did that study look at the

aspect of the integration of Social Security? I think what he was alluding to was the 2 percent relative to the Social Security element, not per se the contributions. I realize it is hard to extricate one from the other, but I think, in fairness, what he was talking about was the element of the contribution of Social Security.

MR. BONE: This study does not get into that level of detail. My sympathy is with them. When you do these studies, you have to put them on a pretty broad level.

SENATOR INVERSO: I hear what you're saying. Whether it is subsidy -- and I guess the CWA doesn't like that word -- or whatever it is, I do not think this was related specifically to the element of integration of Social Security, as opposed to a reduction in establishing an employee rating, saying, "We are going to give you 2 percent towards that rate."

MR. BONE: Let me just say: To isolate that in the context of Social Security, I think, misrepresents the figures. I think the figures we should be looking at are: "Are present employees paying a fair percentage toward their pension system, or are they not?" In the context of comparisons with other states, we are, indeed, paying more than a fair share toward those pensions.

SENATOR INVERSO: That's about what we're doing.

MR. BONE: Next, how well-funded is the TPAF compared to other teachers' plans? The numbers that were cited by the State Treasurer this morning are based on a 1993 Wilshire survey of state plans. In the 1993 Wilshire survey, the average funded ratio for plans -- and this is based on the accrued benefits obligation versus the assets-- The average funded ratio was 89 percent. Now, once again, if I may quickly diverge, this is the measure where actuaries are saying, "If you cancel the plan, no one got future salary increases, etc., what is the accrued benefit versus the level of assets?" So in

measuring that obligation, the interest rate you use affects that obligation, and the future salary increases have no effect.

If you look at the numbers behind this survey that the Treasurer has been citing, other states are using significantly more conservative assumptions than is the State of New Jersey to calculate this number, which is to say that, if you adjust the assumptions used in the New Jersey plan to the average of those for the states, you come up with something perhaps a little higher, but pretty close to the average of all the states.

One other item -- for those of you who actually want to go back and look at the Wilshire survey -- the Wilshire survey shows the State of New Jersey as well-funded when they average their numbers across states on consistent assumptions. The reason for that is because they looked at the State of New Jersey before the pension revaluation, when the State had considerably higher levels of assets to liabilities. The State actuary's own report, on the basis of consistent assumptions, shows that the funded ratio of assets to accrued benefits has declined since the revaluation.

Next, how does the funding of benefits compare with the private sector? If you measured this plan on consistent bases with private sector plans which invest in the same universe, this plan is significantly less well-funded for accrued benefits than private plans. The Federal government publishes an annual list of the top 50 worst-funded plans in the country. Those are private plans. If this were a private plan as well, it would definitely make the list. It would be among the worst-funded plans.

Now, there are different considerations that apply. This plan covers-- By the way, once again, that is looking only at the pension side, which is what the Treasurer's numbers looked at. We have ignored, for this purpose, the funding of retiree medical. There are differences between private sector

plans and public sector plans, but if you are trying to compare how well-funded this plan is versus a private sector plan, you come up with the conclusion that it is definitely not as well-funded.

The 8 3/4 percent interest rate assumption is a reasonable, but aggressive assumption. The Treasurer has criticized the salary scale assumption that is used in calculating the projected benefit obligation. As you pointed out, you need to have a solid relationship between the expected return on the fund and the expected salary scale.

As far as looking at the true accrued benefit obligation measure, using 8 3/4 percent is somewhat high. An insurance company -- if you asked an insurer to take on this obligation for you -- would not take on an obligation measured at 8 3/4 percent. They would measure the obligation probably at somewhere around 7 1/4 percent, based on yesterday's interest rates. I have not seen what has happened to the market today. If you measured it on 7 1/4 percent, of course, you would come up with a significantly worst-funded plan.

Next, "Do the changes in funding achieve tax equity?" Under the proposal, voters in the next couple of years will coast on money that was set aside beginning in the Kean administration. Contributions in the future will be higher than they will be in the next couple of years. Contributions in the past will be higher than they will be in the next couple of years. It is hard to argue that no services are being provided by State employees during this period.

Next, the 40-year amortization period. As Claude pointed out in his testimony, this is not consistent with the terms of ERISA. It was consistent with the terms that were provided for plans that were established when funding was converted to the ERISA standard. The way it is applied in this valuation would not have been permissible under ERISA anyway.

Next, the question of, "When do contributions to the pension fund stabilize?" Under current law, as we said, the contributions to the plan stabilize after the year 2006. Under the proposal, contributions will not stabilize until after 2027. The graphs that you have been shown stop at either 2006 or 2014. The graphs that appeared in the Treasurer's initial testimony overstated the cost of the current program. The question is, "When will the contributions cross over, and how big will the crossover be?" This is something that concerns us, and I am sure it concerns you, as well. That is why we would like to see the better numbers, which we had asked to be provided.

Just a word on the initial numbers. The initial numbers were done based on simplified methods. Those simplified methods do not work well when comparing charging costs under a percent-of-pay basis with charging costs under a projected benefit basis. That is because under the projected benefit basis, the cost changes when people are older, so you have to know how the population ages. You do not have to know how the population ages for the other one. We believe that the projections they have produced on the other one will be interesting. We would like to see what they look like.

Finally, there was a statement by the Treasurer that--

SENATOR CASEY: On that, let me, before you go on-- Did you say there is a 21-year difference in what-- Did I get that correctly? The year 2027--

MR. BONE: Is when contributions under this proposal would be fully phased in, recognizing the full cost of the COLA under the new proposal. Under current law, they would be fully phased in at 2006.

SENATOR CASEY: So what I am saying is, there is a 21-year difference between the old way and the new way. Is that correct?

SENATOR INVERSO: No, 2005--

SENATOR CASEY: Or 2005, or whatever. At 22 then, we will put it.

MR. BONE: I think it differs between the two systems, also. You have different phase ins.

My point is that once you reach 2006 under current law, contributions are stable or decline as a percent of pay. Once you reach 2027, you fully phase in the benefits. Costs still increase as a percent of pay if the population is aging. So the point, when you reach a stable contribution level, has been significantly deferred.

The next question is: "Is the State's proposed method more responsive to changes in the size of the State's workforce?" I currently Chair the Society of Actuaries' Retirement Research Committee. As a member of that Committee, I wrote a paper examining the projected benefit cost method which was published in actuarial journals. My particular contribution to the paper was the private sector accounting and the bibliography. As a result of a search of the actuarial literature, there is no backup for this statement as an overall statement that the projected benefit cost method reflects changes in the workforce faster. It is simply not something you can generalize about. Typically, the methods will depend on the age and service of the people who leave the workforce, and how long it takes for you to spread the changes and costs when someone leaves. They are lengthening the period over which changes are spread. That would seem to me to indicate that the current law method is more responsive to changes in the workforce than the proposed method.

I would like to shift back now, if I may, to the "Implications of Deferring State Contributions." I think it is appropriate to look at this in terms of the alternative ways of spending money. If money is put into the pension fund, it is assumed to earn -- and that is on the second page here -- at a rate of 8.75 percent. If the State has a public bond issue

and goes out to finance the construction of some facility, the State pays somewhere between 6 percent and 6.5 percent. So as a source of revenue, you pay 8.75 percent on money not put into the pension plan, and you pay 6 percent to 6.5 percent on the open market.

When you look at the long-term cost of the plan, the cost to you is the benefits less the employee contributions less the investment earnings on the trust. No matter what the future brings, if you put less money into the trust now and measure on the basis of consistent assumptions about future events, you will have less investment earnings in the trust to offset the costs to the State of future contributions.

SENATOR KENNY: I want to ask a question on that: One of the things the administration has said in terms of future costs, is that because New Jersey systems are maturing-- Have you heard that language? Because the systems are maturing, the actual future costs will be less. I don't know exactly what they mean by that. It is in a number of their explanations as to the future, not only-- It arises, you know, where the lines cross, under their theory -- where you presently have a straight line, where we pay "X" amount of dollars based on these formulas. They want to pay less now, and then the line, arguably, goes up. At some point the line intersects, and would exceed what we are presently paying.

They say that those lines may not necessarily intersect, because our workforce is maturing. I have heard this a few times. I do not know what that means. Do you know what--

MR. BONE: That is an illustration of using inconsistent assumptions under the one method versus the other method. If you say, "Let's fix the amount of benefits we have to pay--

SENATOR KENNY: Right.

MR. BONE: In other words, if the workforce is maturing or not, it does not matter. Whatever the future brings, under your current promises you have committed to paying benefits at certain points. What it is going to cost you to fund those benefits is going to be those benefits less the returns you get on your assets less the employee contributions. So what they are doing is similar to the chart on the retiree medical, where you have current funding under one set of assumptions compared with pay-as-you-go on an entirely new set of assumptions. Of course, if my assumptions are that things are going to cost less, I can show that things cost less. I don't think you need an actuary to make that point for you.

SENATOR INVERSO: I think, Senator Kenny, staff reminds me that they were talking, perhaps, about stability in the rate of growth in the employment force, as opposed to the maturing, or the age of the force. If it was that way, we do not expect a large expansion of the labor force.

SENATOR KENNY: It had to do with the future time under their proposal, when the contributions would be in excess of what they would have been had we stayed on this proposal. Their answer to that is, "Well," and then they talk about the maturation of the workforce. I did not know how that fit in. But I agree, you know, the lines are going to cross. If you pay less now they are going to cross, and later on you are going to have to pay more.

MR. BONE: Yes. Now, there has been some looking at items on inconsistent bases. Those were the problems with the initial numbers that were presented in their testimony. Those numbers assumed that you would not have aging for purposes of measuring the current cost method, and that, in essence, you would have salaries growing at 6 percent. Yet, on the other method, you had some sort of an assumption about the workforce staying stable. Aging on one, stable on the other. The

assumptions are implicit. We have asked for better work to be done. Our understanding is that they have done that work. We would like to look it over before we respond to your comment fully.

One of the big considerations we have in trying to measure the cost of the State's proposal is that it requires you to look at how the population ages. We do not have the data and resources to do that at this point. The State actuary does. We have asked for that information to be provided, so that we can look at it as well. But, yes, that is a very key consideration.

I think, finishing -- which, I am sure, should be a good sign--

SENATOR INVERSO: I was thinking up here -- if you don't mind me saying this-- I thought the most boring event was two CPAs getting together. I am now convinced that it is two actuaries getting together. (laughter)

MR. BONE: Well, at this point--

SENATOR INVERSO: I'm a CPA, so you understand I put my-- You know, no offense.

MR. BONE: --if I may, I would like to identify a brief guide for identifying the various types of actuaries, so you can tell whether you are getting boring ones or not. This is a joke which my boss told to the U.S. Senate, as a matter of fact. My boss is Italian. He asked if you knew how you could--

SENATOR INVERSO: Well, he must be a good guy, obviously. (laughter)

MR. BONE: He asked if you could---

SENATOR INVERSO: I have already accepted all of your input. I am going to go to a meeting across the street and hammer it out for you now.

MR. BONE: --distinguish between the Italian actuaries and the other actuaries. The answer, of course, is that a

regular actuary can tell you how many people are going to die, and the Italian actuary can tell you who and when. (laughter)

If I may move back to the end of this, I think the key point is that if you measure this on the basis of consistent assumptions about what your benefits will be, putting less in now is going to cost you more later. The money will grow at either 8 3/4 percent, or whatever the fund would have returned. The only time when it is cheaper to borrow at 8 3/4 percent than the 6 percent to 6.5 percent the State would borrow in if they had a bond offering, is if you do not intend to repay what you are borrowing at 8 3/4 percent; in essence, if in the future you will be cutting benefits, and therefore not making those repayments. That is the key concern here.

SENATOR INVERSO: Okay.

SENATOR KENNY: I have to say something about CPAs--

SENATOR INVERSO: I didn't take on attorneys, now.

SENATOR KENNY: --and a conclusion about actuaries: I have been out with CPAs, and when they are not doing their CPA stuff they have a lot of fun, and they have a very good time. Actuaries must be absolutely wild. (laughter)

SENATOR INVERSO: Life is short. You have to let it out one time or another, obviously.

Are there any questions?

SENATOR CASEY: I think, on the last statement you made -- and I agree with you, this is one of my major concerns-- The money in the future will be borrowed today and not paid back, because future legislators and Governors are just going to say, you know, as we do in government. I think that is a very scary point.

MR. TESTA: Mr. Chairman, if I may just conclude by saying the NJEA is very interested in finding a solution to the budget proposals made by the Governor. We have no interest in perpetuating a political struggle between the administration and the NJEA. Our goal is to make sure that we can assure the

soundness of both the health benefits coverage for our members and the stability of the pension plan, and find a solution to the 2 percent history that has been discussed.

We would love to be a cooperative force in the running of this State and in the stability of the State of New Jersey.

Thank you.

SENATOR INVERSO: It is good to hear that. Hopefully we can do something.

I have two other speakers listed. Then we will conclude, because they will be booting us out of here soon.

Pasquale J. Nardelli. Pasquale is with the Retired Police and Firemen, New Jersey State. You're a trustee, aren't you? (no response)

P A S Q U A L E J. N A R D E L L I: I am going to be very brief.

SENATOR INVERSO: Okay, thanks.

MR. NARDELLI: I represent about 10,000 retired policemen and firefighters in the State of New Jersey. Clearly, we are aligned with all the groups that are here today, and are making opposition to the proposed budget that the Governor has put forth. We do not want anyone to touch our pension fund.

But the big question my members keep asking me that they would like an answer to -- and it is going to be rather confusing and very difficult for me to answer after seeing all of these charts and listening to two different actuaries here talking about two different systems-- My people want to know: How is the proposed plan of the Governor concerning the 1995 budget going to affect the health benefits of our retirees?

Have you any idea?

SENATOR INVERSO: I will tell you what the administration has said and what is, at this juncture, reflected in the budget. There is no change. There is no impact on that, Pat.

MR. NARDELLI: No impact? You know, most of our retirees are up there in years, and they are worrying about this.

SENATOR INVERSO: The budget does not include any proposal at all that would impact the provision of health benefits to retirees.

MR. NARDELLI: I hope so.

Thank you very kindly.

SENATOR INVERSO: Thank you.

Edward Kahn, Local 194, Turnpike Employees.

E D W A R D T. K A H N: That's right. Thank you, Mr. Chairman.

SENATOR INVERSO: Ed, before you sit down, are you going to be more than three minutes?

MR. KAHN: No, I will keep it short.

SENATOR INVERSO: The reason I am asking is that if you are, I am going to go to the men's room (laughter), but if you are not, I will stick around.

MR. KAHN: No, I will keep it short. I will attempt to keep it short. I have a three- or four-page statement that I would like to read from.

I am here today representing not only the New Jersey Turnpike Employees' Union, Local 194, but as a representative of the Public Employees' Committee, which represents over 300,000 public employees in the State of New Jersey.

Chairman Inverso and members of the Committee, I appreciate this opportunity to appear here today on behalf of our members. I hope I can convey to you their feelings of outrage and betrayal over the proposed changes in their pension system.

First of all, it has become quite evident, from everything we have heard here this morning and early this afternoon, that the proposed changes are not intended to improve the system. Presently, PERS is working well and, in

fact, it has been working well for decades. It has accumulated adequate funds, distributed its retirement obligations, and balanced its books in an outstanding manner, while continuing to set aside appropriate funding for its future obligations. In a nutshell, "It ain't broke."

However, the proposed changes will break the system. Having accumulated \$36 billion of reserves, it is quite tempting to steal the money, or to draw it down and deplete the reserves, pay obligations out of those reserves, and reduce contributions to an irresponsibly low minimum. This is being referred to as the "unit credit funding method." You heard about this from the experts prior to my coming out to speak this afternoon; you heard from two actuaries, and you heard from the CWA and the NJEA specific to the unit credit funding method. The method funds only the year-to-year increase in liability. Its Pied Piper is the State Treasurer, Mr. Clymer. While he cites some major companies which use this system, he omits the fact -- which was pointed out today -- that those companies are covered by ERISA, and their future liabilities are federally insured.

Shockingly, Mr. Clymer predicts that, to continue the present system, the State's obligations will reach intolerable levels. In the next breath, he says that unless his proposed changes take place, there will be a big "windfall" for future taxpayers.

On April 14, Mr. Clymer told the Assembly Budget Committee that continuing the present system would "create a future windfall." What is the prospect of adopting the system being proposed? A thoughtful article in The Wall Street Journal of April 6 -- which I am attaching to my printed statement, which I would like to hand out -- gives a clear and unmistakable picture. The Wall Street Journal cites specific instances in those states that have attempted to propose

revisions and propose reforms, that those states are now cutting their benefits, and further increasing employee contributions.

First what would happen is that state governments and some private employers would rape their pension funds. With the same protests we hear today, they say, "This is not going to affect benefits." When the money is gone, or the money is nearly gone, they panic. Only it is a few years later and the "new" Governor and the "new" Legislature are stuck with the problem. I will use their own charts to show you. This is what we are referring to. It is their own charts that show the balloon in the payments of the State, and show that the pension payments will become an ever-increasing proportion and burden of the State budget. That is where the cry is going to occur. That is where my four year old will become a member of the working population of this State of New Jersey, and that is where my two sons will have that burden -- right there.

Now, if I were to ask you today, "Is it your intention to cut pension benefits?" you, too, would say, "No," and we believe that. You might even be shocked and dismayed that we would even think that you would, but the truth is, that is just where this whole thing is heading if the pension revisions are adopted.

What is even more mean-spirited -- what I would like to speak directly to you on today -- is the public relations efforts of the administration to stir up the taxpayers against public workers. In the testimony at hearings, interviews with the news media, and on call-in radio shows, Mr. Clymer and his sycophants have attempted to turn this into a social battle -- an us against them battle. The administration propaganda leaflets, much like some letters we have received from legislators, repeat the same fallacies. They always wind up with the fact that they are championing the "taxpayers" against the "special interests," the "good guys" against the "bad

guys," "the "white hats" against the "black hats." Shame on them, shame on them, shame on them, because we are not special interests.

We are working men and women. We have not had an improvement in our pension system in over 20 years. Since 1966, when our pensions were separated from Social Security, we trust the government, Republicans and Democrats, to do the right thing. Through all those Governors and through all those Legislatures, PERS continued on a sound basis. The proposed changes have caused concern with bond rating firms, actuaries, and even your own Office of Legislative Services. If you have not studied the OLS report, I urge you all to do so. Just two years ago, your own actuaries supported the prefunding of health benefits and the cost-of-living, and you adopted it. Now, the proposal is to abandon the program which you only recently enacted.

As a Committee on Investments, it is hard to believe that your members will buy into this chicanery and take a working system which isn't broken, and break it.

Concerning the proposed 2 percent increase in employee contributions to PERS, it is quite evident that proponents have little regard for their predecessors and the Legislature. They would have you believe that in 1966, when the PERS was separated from Social Security, that no one knew about the 2 percent, notwithstanding the fact that many State officials and legislators had been there for years. I was just given, this morning, a copy of Chapter 67 of the Laws of 1966. I will quote out of the Laws that, in fact, they recognized the 2 percent, took it into their actuarial considerations back in '66, and decided that the employee contributions would remain as they were, because that was what was needed. It says: "Effective January 1, 1967 and thereafter, an amount equal to 2 percent of the compensation subject to Social Security, upon which such members' contributions to the retirement system are

based, shall be deducted from the contributions required to be paid to the retirement system by such members, as provided in Sections 25 and 60 of this Act in 1966." The Legislatures then knew about it.

Our consultant and former business manager, Frank Forst, testified before the Joint Assembly and Senate Budget Committee that he was there. He testified to that Committee that he was there. Subsequently, because some legislators doubted that he was there, that he was involved in those negotiations, I accompanied him to the Rutgers University Library.

All newspapers carried the story. This is a copy of the story that appeared in The Evening Times on May 2, 1966 (holds up copy of article), when 1700 highway workers marched to Trenton and stood on the steps of the State Capitol with signs that said, "Separate pension from Social Security." Frank testified that on that day he met with Governor Hughes, Senate President Si Ridolfi, House Speaker Bob Halpin, Majority Leader Paul Policastro, and Fred Hauser, Assemblyman, who had introduced the bills to separate the systems. He reported that the 2 percent was thoroughly reviewed with the status of existing reserves, levels of contributions, and a history of earnings in excess of actuarial estimates. This is a fact that this administration would like to forget, but you cannot revisit history, and we will not allow it to happen.

Also discussed was the fact that, due to the Social Security deduction from State pension benefits, most, if not all, blue-collar workers and clerical workers, numbering in the hundreds of thousands in State, county, and municipal governments, had contributed to the PERS system for decades, and received no benefit. They received zero -- zilch. Yet, all their moneys, even at the 2 percent reduced rate, were still in the fund, as were all the earnings on their contributions. In reality, because of the Social Security

offset, they had not received a subsidy, but were, in fact, subsidizing the system. This fact was reviewed and certified by the same actuarial firm that is here today. The level of employee contributions was continued after the bifurcation of the systems.

Now, almost 30 years later, someone would have you believe that that Legislature, which adopted separation without opposition in either House, did not know what it was doing, or was ignorant, or was mistaken. On the contrary, they were the well-informed. The subsidy, from the very beginning, was a sham, considering the wage levels of workers at the time and the minimum Social Security benefits in 1966.

To increase employee contributions without increasing benefits is uncalled for, especially at a time when the administration is representing to you that PERS is overfunded, not underfunded -- and on a pretext which is erroneous. That 1966 program had total bipartisan support. Were they all a bunch of dummies? I don't think so, and I know you and your associates are not, either.

We believe that you will approach the fiduciary responsibility for our pensions with wisdom and prudence. Perhaps some reasonable changes are necessary, but it would be totally unfair to just rip and shred the system apart just to take the money. It would be equally unjust to raise employee contributions by as much as 30 percent to 50 percent.

We hope and trust you will consider what we have said, and come to a fair resolution.

Thank you for your time.

SENATOR INVERSO: Thank you. I'm sorry you had to wait so long.

MR. KAHN: I'm sorry you have to go to the bathroom, but I--

SENATOR INVERSO: I am, too; actually, I am, too, but now the whole world knows. I'm sure it won't be on the record.

Are there any questions for Mr. Kahn? Does anyone want to prolong my agony, or--

Thank you very much, Mr. Kahn. I appreciate your input.

Thank you all for attending.

(MEETING CONCLUDED)

New Jersey State Library

APPENDIX

PENSION REFORM

PROPOSAL

**DIVISION OF PENSIONS AND BENEFITS
APRIL, 1994**

R

PENSION SYSTEM REFORM PRINCIPLES

- **BENEFITS SHOULD NOT BE ALTERED**
- **ACTUARIAL ASSUMPTIONS SHOULD REFLECT CURRENT ECONOMIC CONDITIONS**
- **PUBLIC EMPLOYEES SHOULD CONTRIBUTE THEIR FAIR SHARE**
- **TAXPAYERS SHOULD PAY ONLY THE AMOUNT NECESSARY TO GUARANTEE THAT SUFFICIENT FUNDS ARE AVAILABLE TO PAY FOR ALL BENEFITS WHEN THEY ARE DUE (WHEN MEMBERS RETIRE, DIE OR WITHDRAW FROM THE SYSTEMS)**
- **ONE TIME SAVINGS SHOULD BE AVOIDED**
- **ALL REFORMS SHOULD BE IN ACCORDANCE WITH ACCEPTABLE ACTUARIAL PRACTICE**

QUICK REVIEW OF PROPOSED PENSION REFORM CHANGES

- **Post-retirement health benefit funding**

Eliminate the pre-funding of post-retirement health benefits. Fund on a pay-as-you-go basis.

- **Budgeting pension costs**

Change to a unit credit funding method from the entry age normal funding method

- **Amortization period for liabilities**

Change to a 40-year funding period from the current 30-year period.

- **Eliminate the 2% employee contribution offset**

Eliminate the 2% employee pension contribution reduction that was originally due to benefit integration of the pension/ social security systems. This integration was eliminated in 1966.

- **Phase-in of the revised actuarial assumptions for the TPAF**

Extend phase-in period for recognizing the revised actuarial assumptions (mortality tables) in the TPAF from 2 years to 5 years.

- **Decelerate the phase-in of full pre-funding of COLA costs**

Revert to the phase-in schedule used prior to the 1992 pension reform legislation. There, COLA's were to be pre-funded at between 20% and 24% of accrued liability. Presently, the law requires funding of between 34% and 97% of accrued liability, depending on the system.



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April 4, 1994

The Honorable Brian W. Clymer
Treasurer, State of New Jersey
State House
Trenton, NJ 08625

Re: Proposed Pension System Reform - Fiscal Year 1995 Budget

Dear Mr. Clymer:

I am writing to comment on the proposed Pension System Reforms included in the Fiscal Year 1995 Budget as they relate to the Judicial Retirement System, the Police and Firemen's Retirement System and the State Police Retirement System for which we serve as actuaries. The three proposals which relate to one or more of the above-mentioned retirement systems are:

1. Eliminate prefunding of post-retirement medical benefits and switch to a pay-as-you-go method;
2. Switch from the current entry age method of funding pensions to a "unit credit" method; and,
3. Extend the period for amortizing the unfunded liability in the pension systems to 40 years.

The first of these proposals would only effect two of the systems - the Judicial Retirement System and the State Police Retirement System. The other two proposed reforms would effect all three of the above-mentioned systems. We will comment on each of the three proposed reforms in turn below.

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Mr. Brian W. Clymer
April 4, 1994
Page Two

One of the significant changes enacted with the 1992 pension revaluations was the initiation of advanced actuarial funding of post-retirement medical benefits for both the Judicial and State Police Retirement Systems. The prefunding was to become effective in Fiscal Year 1995. Since the enactment of that legislation, initiatives for health care reform have been proposed by the President and are currently under active consideration by the Congress. Included among the President's proposals would be a provision which would have the federal government assume a major portion of the cost of providing health insurance to retirees over age 55. While it is premature at this point to conclude that there will be a significant change in the magnitude of employer responsibilities for providing health insurance to retirees in the event reform is enacted, it seems reasonable at this point to defer the change from pay-as-you-go funding which has been in effect through fiscal year 1994 until a reform program is enacted.

With respect to the proposed reform of switching from the current entry age method to a "unit credit" method, the proposal would involve utilizing the projected unit credit actuarial cost method. This has become the standard cost method utilized within the private sector for purposes of preparing financial statements since the adoption of Financial Accounting Standards Board Statement No. 87. Moreover, the projected unit credit method is the method adopted by the Governmental Accounting Standards Board ("GASB") in Statement No. 5 regarding "Disclosure of Pension Information by Public Employee Retirement Systems and State and Local Governmental Employers". Moreover, the projected unit credit method is one of the acceptable methods specified in a recently issued exposure draft from GASB regarding "Accounting for Pensions by State and Local Governmental Employers". Accordingly, this proposed reform is reasonable.

With respect to the third proposed reform extending the amortization period for unfunded liabilities to 40 years, the previously cited exposure draft recently issued by GASB would set the maximum acceptable amortization period for the total unfunded actuarial liability as 40 years. (The maximum acceptable amortization period would gradually be reduced over a 10-year period following the effective date of that proposed statement so that the maximum acceptable amortization period would ultimately be fixed at 30 years.) It is worth noting that in the exposure draft, GASB discusses its reasons for allowing the initial maximum period of 40 years at some length in paragraphs 104 through 108. Included in that discussion is a reference to the fact that prior exposure drafts had prompted commentary that "the existing accounting maximum of 40 years had worked well for many years and should be retained" (paragraph 107). Thus, there is a precedent for the use of amortization periods of 40 years for public sector retirement systems and the adoption of a 40-year period by New Jersey would also appear to be reasonable based on current practices among public retirement systems.


Mr. Brian W. Clymer
April 4, 1994
Page Three

On the basis of the foregoing, we believe that each of the above three proposed reforms are reasonable. Since the effect of adopting these proposed reforms would be to reduce the level of contributions to the retirement systems in the future, emerging actuarial experience should be carefully monitored so that contributions can be adjusted to reflect any unfavorable deviations in actual experience from that assumed.

We would be delighted to respond to any questions you may have regarding the above comments or any other actuarial aspects of these retirement systems.

Respectfully submitted,

MILLIMAN & ROBERTSON, INC.

By: 
William A. Reimert, F.S.A.

WAR:wat

cc: Margaret McMahon

BUCK CONSULTANTS

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Secaucus, New Jersey 07096-1533

March 23, 1994

The Honorable Brian W. Clymer
Treasurer, State of New Jersey
State House - 1st Floor
CN 002
Trenton, NJ 08625

Re: Proposed Changes in Design and Funding Policies

Dear Mr. Clymer:

As requested, we are writing to comment on the proposed changes in the present design and funding policies of State PERS and TPAF. We have discussed the specific recommendations in light of common practice in various memos summarized in our "Summary and Cost Analysis" brief.

In summary, the proposals include the following:

1. Change the actuarial funding method from entry age (frozen initial) to the projected unit credit method.
2. Extend the amortization period for the unfunded accrued liability from 30 years to 40 years with the contribution expressed as a percentage of pay.
3. Eliminate the prefunding of postretirement health benefits and revert to pay-as-you-go funding.
4. Modify the phase-in recognition of the active population cost-of-living benefits to reflect the current phase-in point from the original refinancing with approximately a 2.5% annual escalation in the future.
5. Eliminate the 2% member subsidy on required contributions up to the Social Security wage base limit.
6. Extend the phase-in period for recognition of the latest TPAF experience changes from two years to five years.

Each of these proposals reduces the contribution requirements of the Systems' sponsors. As such, the resulting funding policy must be viewed as less conservative. This is not to suggest that the proposed policy is unreasonable from an actuarial viewpoint. It simply means that the

The Honorable Brian W. Clymer
March 23, 1994
Page 2

proposed policy will require close monitoring to ensure that the future benefits continue to be secured by adequate pre-funding. To this end, we would expect the triennial experience studies to be expanded to include an analysis of the funded status of each System along with the regular analysis of each specific assumption. This added review should help to ensure the continued health of each System.

With regard to the specific proposals, we believe the proposed funding method must be viewed as acceptable based on common practice and the technical recognition of the method by the Actuarial Standards Board. We support this change, assuming the appropriate monitoring is completed as discussed above.

The use of a 40-year amortization period is prudent for the Systems and is permitted under present statutes. Both common practice and the ERISA legislation support this modification.

While the reversion to pay-as-you-go funding for postretirement health benefits is a dramatic step, the current environment in this area supports reconsideration of the present policy. Specifically, the moderation in medical inflation levels and the uncertainty relative to benefit coverage warrants caution in this area. The proposal provides a temporary period of less aggressive funding to allow the present uncertainty to be resolved. At that point, the issue of prefunding can be reconsidered from a more knowledgeable standpoint.

Modifying the phase-in periods for COLA and for the anticipatory assumption changes under TPAF are reasonable from an actuarial standpoint given the historical records in these areas.

The change in benefit design relative to the 2% member subsidy appears logical, but we have no opinion on this change from an actuarial viewpoint.

We would be pleased to expand on these comments if additional input would be helpful.

Kindest regards,



Robert D. Baus
Principal & Consulting Actuary

RDB:KT
Enc.
DOC:L13214VT.WPS

pc Margaret McMahon

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BUCK
CONSULTANTS

STATE OF NEW JERSEY

1994 BENEFIT AND FUNDING POLICY PROPOSALS -

SUMMARY AND COST ANALYSIS

As part of the budget analysis and planning for the next fiscal year, certain proposals are being made with regard to the design and funding policies for various of the State's pension systems. In particular, the following recommendations have been included in the proposed budget:

1. Change the actuarial funding method from entry age (frozen initial) to projected unit credit.
2. Modify the amortization period for the unfunded accrued liability from 30 years to 40 years with the contribution expressed as a percentage of pay.
3. Eliminate the prefunding of post-retirement health benefits and revert to pay-as-you-go financing.
4. Modify the phase-in recognition of the active population cost-of-living benefits to reflect the current phase-in point from the original refinancing with approximately a 2.50% annual escalation in the future.
5. Eliminate the 2% member subsidy on required contributions up to the Social Security wage base limit.
6. Extend the phase-in period for recognition of the latest TPAF experience changes from two to five years.

Each of these proposals is reviewed in the following pages along with the cost implications.

ITEM I

PROJECTED UNIT CREDIT FUNDING METHOD

(TO REPLACE THE ENTRY AGE FUNDING METHOD)

There are a number of "acceptable" actuarial funding methods used in connection with the budgeting of pension costs. Note that these are budgeting tools -- the various methods simply effect the time of contributions.

From a common practice viewpoint in the public sector, 16 of 27 states surveyed in 1989 used entry age with 2 using unit credit. Today there are at least 30 states presently using the entry age method but 6 are now using unit credit.

Despite the low usage in the public sector, the unit credit method is a very acceptable funding method as can be seen by looking at the private sector. The vast majority of private sector plans use the unit credit funding method. The Financial Accounting Standards Board requires the use of this method for expense purpose for all private sector plans. As a result, it would be difficult to fault a change to this method. (Note that the courts in New York overturned a decision to use this method for certain of the New York State systems on account of the adoption procedure -- not based on the merits of the method.)

The entry age and unit credit funding methods budget for pension costs differently with regard to the calculation of the liability for service to date and in the determination of the costs for benefits accruing in the future. The entry age method determines the liability for future service based on the value of contributions which would have been payable over an employee's entire career

in order to fund his or her pension. This level of contribution will not have been paid as a result of plan changes and actuarial experience (e.g., salary increases) which are different than those expected. The difference between the total system liabilities and the value of these hypothetical "entry age" contributions is the System's accrued liability. To the extent this liability exceeds present assets, the difference is set up as an amount to be funded (or amortized) over a fixed period -- much as a mortgage is paid off.

Under unit credit funding, the accrued liability is calculated directly as the value of benefits accrued to the valuation date. The difference between this value and the available assets is again set up as an unfunded liability to be funded over a fixed period. The cost for benefits currently accruing is simply the value of the benefits to be earned in the year following the valuation date.

By comparison, the entry age method results in a more level contribution pattern as a percentage of pay. Nevertheless, the unit credit method generates costs which are directly attributable to the value of benefits currently being earned. The result can be a level percentage of pay contribution pattern if the Retirement System is still maturing -- as are the New Jersey Systems. Under projected unit credit, the costs will tend to escalate over time as a percentage of pay as the retirement population matures in future years. As a result, the unit credit method generates lower costs initially, with higher costs later on when measured as a percent of pay assuming a stationary population. If the population is decreased, the resulting contribution pattern is likely to be more stable or decreasing as a percentage of pay. The chart following Item 2 illustrates the potential savings for PERS and TPAF as a result of this proposal, as well as the use of a 40-year amortization period.

ITEM 2

**USE OF A 40-YEAR AMORTIZATION
PERIOD (PERCENTAGE OF PAY BASIS)
FOR THE UNFUNDED ACCRUED LIABILITY**

Under the entry age or unit credit funding methods, a portion of each System's accrued liabilities are presently unfunded. These amounts are typically handled like a mortgage -- they are funded over a fixed period using level dollar contributions or as a fixed percentage of pay. We understand that the New Jersey statute currently provides for a period of up to 40 years for this purpose (this point should be verified with counsel). The 40-year period was selected as reasonable based on common practice, the economic results of the 1989 studies of the Systems prepared by two nationally recognized actuarial firms and the precedent of the ERISA legislation. The argument for this period is bolstered in the public sector by the relative permanence of the sponsoring entities. The present policy as implemented used 30 years as the initial funding period with the possibility for the contribution rates determined on this basis to increase if funding proved insufficient. The funding period could also be extended in certain other circumstances. In any event, all of these analyses and arguments support a 40-year period for this purpose.

The chart on the next page summarizes the present and anticipated annual cost savings resulting from the adoption of items 1 and 2.

ESTIMATED ANNUAL SAVINGS *

FOR THE PROPOSALS IN ITEMS 1 AND 2

	'94	'95	'96	'97	'98
PERS STATE					
Current	148.4	198.5	233	260	280
Revised	121.4	160.5	188	210	227
Savings	27	38	45	50	53
TPAF					
Current	380.5	585.0	725	815	896
Revised	356.5	503.0	561	605	650
Savings	24	82.0	164	210	246
PERS LOCAL					
Current	138.6	191.3	225	252	280
Revised	100.6	117.3	121	123	131
Savings	38	74	104	129	149

* Proposal #1

Change the actuarial funding method from entry age (frozen initial) to projected unit credit.

Proposal #2

Modify the amortization period for the unfunded accrued liability from 30 years to 40 years with the contribution expressed as a percentage of pay.

ITEM 3

**ELIMINATE PREFUNDING OF
POSTRETIREMENT HEALTH CARE COVERAGE**

Program Description

The State of New Jersey presently provides 100% of the cost of post-retirement medical (PRM) coverage for certain retired employees. In particular, a retired State employee under PERS and retired teachers and other employees of local boards of education under TPAF and PERS who have completed 25 years of service or who are retired under the disability provisions of those programs are covered for medical benefits after retirement. This coverage includes the cost of the sponsor provided benefits, as well as the Medicare Part B premium. For the 1994 fiscal year, these annual costs per individual are approximately as follows:

Coverage	Pre 65	Post 65 + Medicare Part B		Total
Single Retiree	\$2,880	\$1,601	+ 439	\$2,040
Retiree w/Spouse	6,170	4,484	+ 878	5,362
Retiree w/Family	7,343	5,658	+ 878	6,536

For the 1995 fiscal year, these annual costs per individual are approximately:

Coverage	Pre 65	Post 65 + Medicare Part B		Total
Single Retiree	\$2,785	\$1,459	+ 523	\$1,982
Retiree w/Spouse	5,960	4,085	+ 1,046	5,131
Retiree w/Family	7,093	5,154	+ 1,046	6,200

History

State employees began to receive PRM coverage in 1972. Up until 1987, these benefits were provided on a pay-as-you-go basis with no advance funding. In 1987, the decision was made to extend coverage to TPAF members and to prefund the benefits (as well as post retirement COLA benefits) under the retirement system. To this end, liabilities for retirees are fully recognized and funded through the annual contributions. Generally, liabilities for the active teacher membership were recognized only to the extent of 3-1/3% of their value in 1987, increasing by 3-1/3% each year until 100% of the value was to be recognized in 2017. (The PERS parameters for phase-in were somewhat different and were adopted in 1990.)

The pension refinancing package, adopted effective with the 1990 valuations, changed a number of aspects of the then existing funding policy. Generally, among the changes was an acceleration of the recognition of the active employee post-retirement medical (PRM) liability to 31-1/4% with anticipated "jumps" over two years to 56% in 1993 after which the phase-in was to accelerate 4% per year to 100% in 2004. However, Chapter 8, P.L. 1993 revised this schedule to 34-1/2% in 1992, escalating 6% per year to 100% in 2003. This schedule remains in effect today with the latest valuation as of March 31, 1993 using a 40-1/2% phase-in factor.

It should be noted that this policy of funding PRM's was adopted at a time when virtually no one else was funding these benefits. New Jersey has been one of the leaders in this respect with regard to PRM funding. Because of the size of these liabilities and the potential for significant continued escalation this was a responsible decision for the State to make given the circumstances at that time. These circumstances have changed as discussed below. The lack of funding elsewhere was readily

attributable to Federal restrictions (in the private sector) and budgetary constraints, as well as a lack of common practice, in the public sector. Buck's latest survey indicates that as of 1994, only seven states out of 34 responding presently prefund any PRM's.

Recent Developments

Since 1990, two very dramatic and probably related developments have occurred.

First, medical trend rates (inflation) have decreased dramatically from the mid to high teens (or more) to a level which in general is below six percent. In the case of the State of New Jersey's increases, the latest annual renewals for fiscal 1995 show a negative impact; i.e., reduced rates for this coverage. The significant change in inflation levels raises the issue of intergenerational taxpayer equity. This issue was a keystone of the studies on funding policy produced in late 1989 and has been an important aspect of the recent changes in funding policy. The lower medical trend rates raise a concern that the State may be over-funding for these benefits today to the disadvantage of current taxpayers. In simple terms, we do not want to over budget (and over tax) today, if it leads to a windfall for future taxpayers.

This situation is complicated significantly by the present deliberations in Washington on health care reform. While present thinking indicates that the Clinton proposal will be subject to considerable debate and modification, there is significant agreement that some type of reform is almost certain to be adopted. There is also general agreement that the final version will, to a significant degree, impact the long term cost of health care in the United States.

This result will have a dramatic impact on the State's health coverage. It is impossible to know at this point what this impact will be and how it will affect costs. Given this dramatic uncertainty, it is again appropriate to review the medical cost funding policy.

When considering this issue, it may be helpful to review the present and expected annual benefit levels versus the level of annual contributions:

System	PRM Premiums Fiscal '95	PRM Contribution Fiscal '95
PERS	\$ 42.4	\$ 113.7
TPAF	109.6	248.3
Total	\$ 152.0	\$ 362.0

*In millions.

Attached are graphs and tables which present anticipated benefit and contribution levels for both PERS and TPAF.

As can be seen, even though we are only funding for 40.5% of the present active population's anticipated PRM benefits, significant prefunding dollars are presently being contributed. The impact of the reduced medical inflation levels, combined with the anticipated health care reforms could easily reduce present contribution requirements by over 50%. Given this situation, it may be appropriate to revert to pay-as-you-go funding, at least for a temporary period, until the reform issue is clarified and we have better experience with regard to the impact on future medical inflation levels. Once these points are clarified, we will be in a better position to determine the appropriate funding policy for PRM benefits.

The anticipated financial impact of this proposal is summarized in the table on the next page.

ESTIMATED ANNUAL SAVINGS FOR PROPOSAL 3

**

	'94	'95	'96	'97	'98
PERS STATE					
Current	148.4	198.5	233	260	280
Revised	71.0	87.3	103	118	131
Savings	77.4	111.2	130	142	149
Shortfall	0	30*	50	60	70
Net	77	81	80	82	79
TPAF					
Current	380.5	585.0	725	815	896
Revised	190.2	337.0	421	463	500
Savings	190.3	248	304	352	396
Shortfall	0	0	20*	140	160
Net	190	248	284	212	236
PREMIUMS					
PERS	38	42	50	60	70
TPAF	90	110	125	140	160

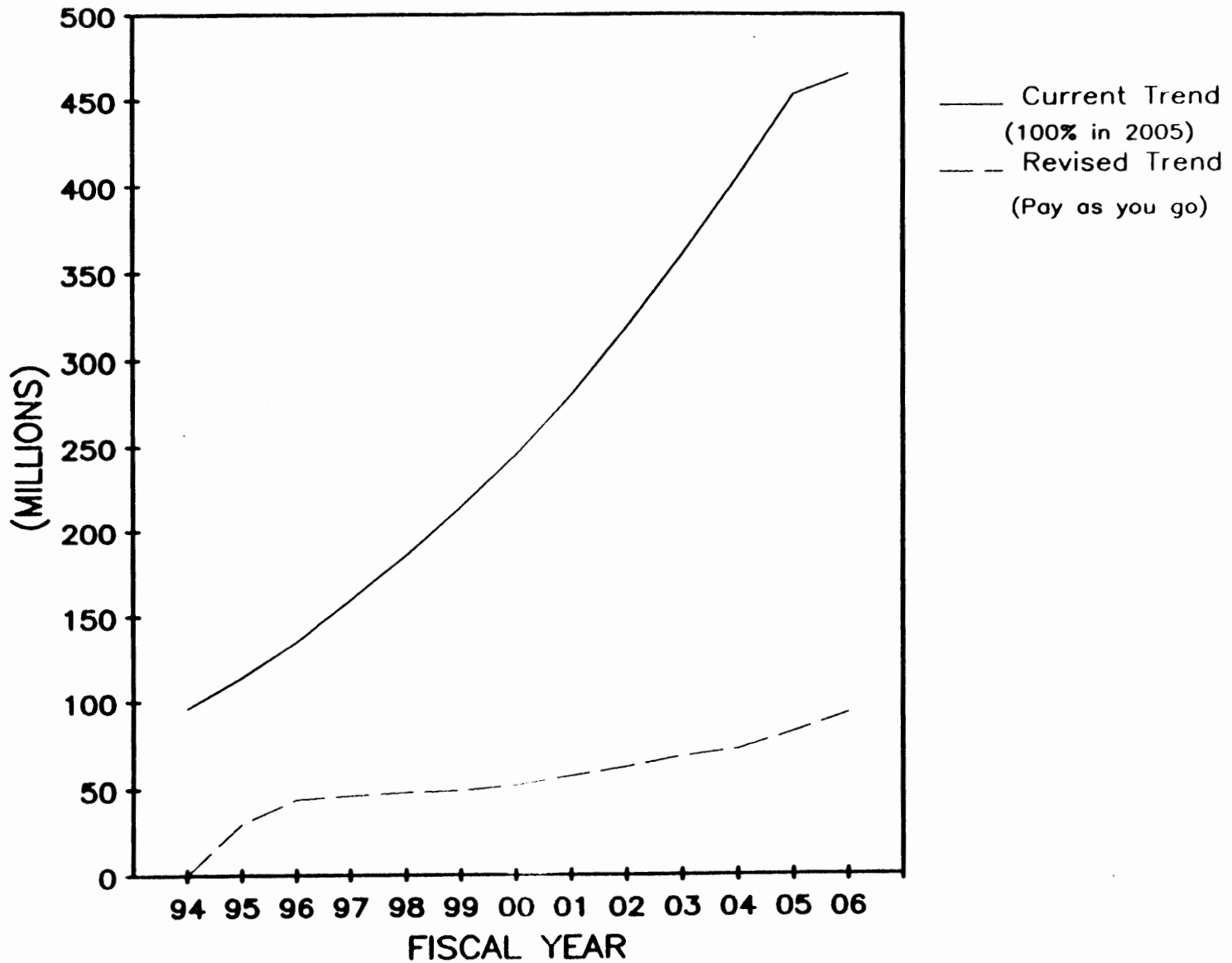
*Current year premiums offset partially by surplus PRM assets.

** Proposal #3

Eliminate the prefunding of postretirement health benefits and revert to pay-as-you-go financing.

NEW JERSEY - PERS

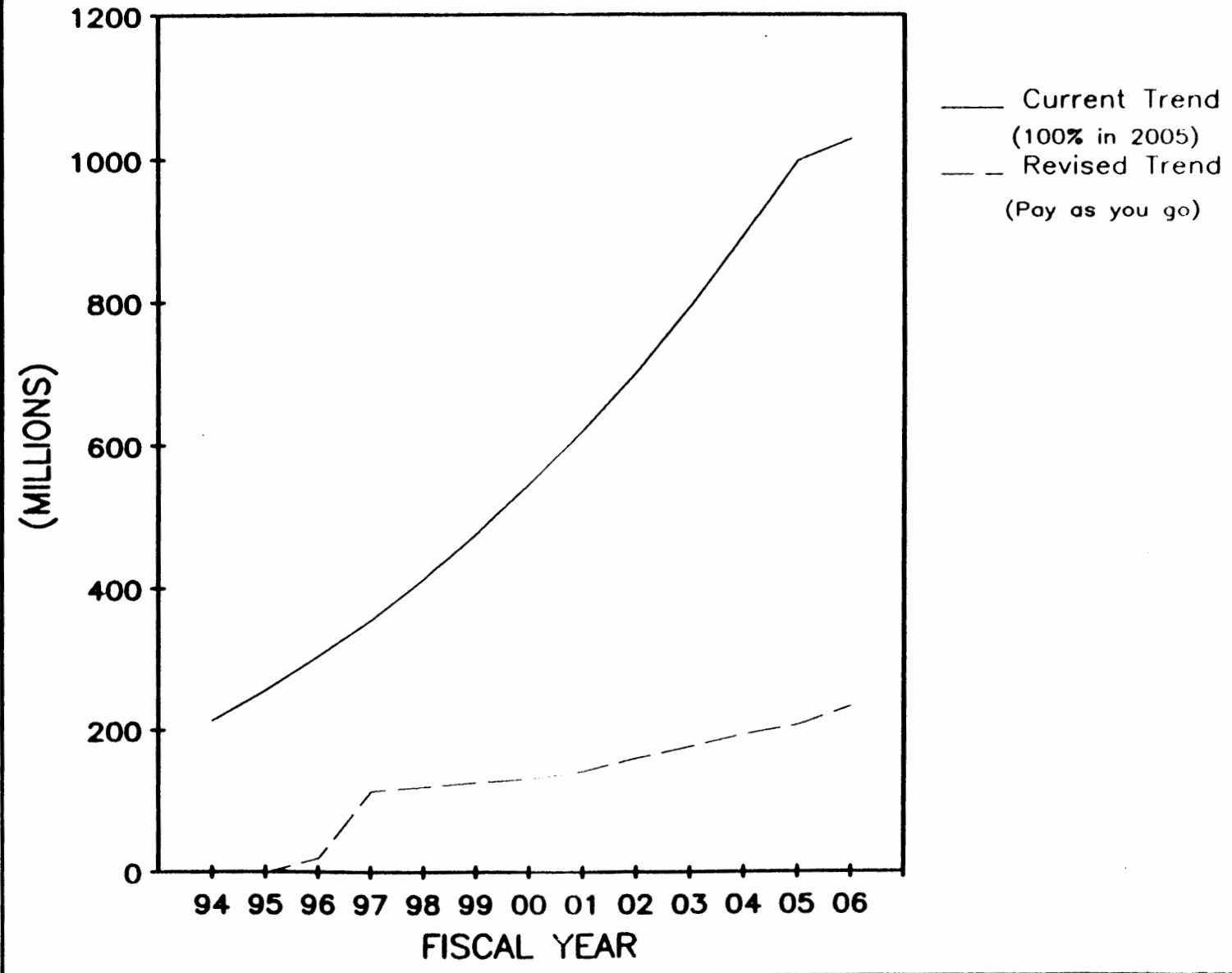
PROJECTED POST RETIREMENT MEDICAL CONTRIBUTIONS



161

NEW JERSEY - TPAF

PROJECTED POST RETIREMENT MEDICAL CONTRIBUTIONS

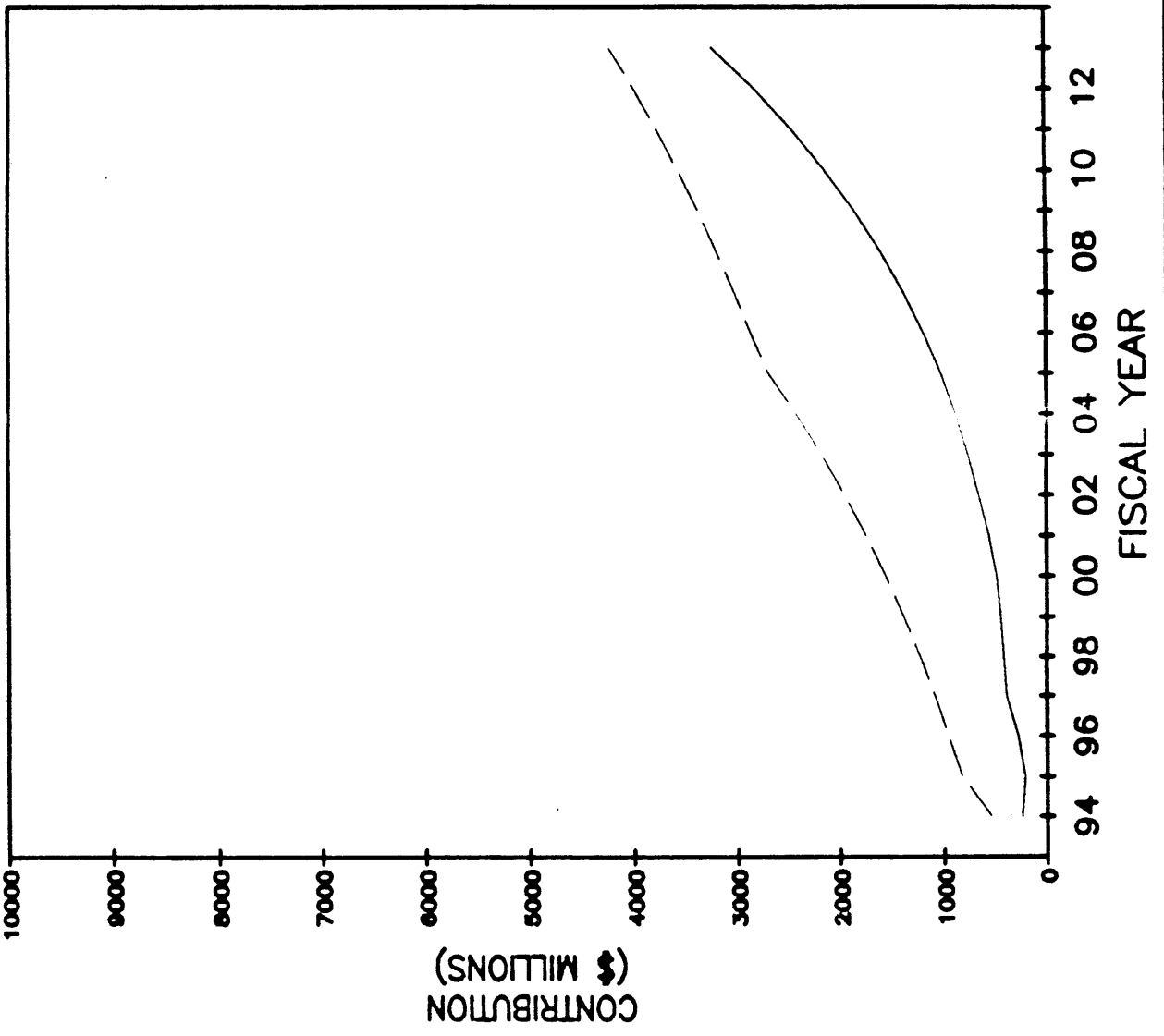


20X

NEW JERSEY STATE CONTRIBUTIONS

FUNDING POLICY

- PROPOSED
- - - CURRENT



ITEM 4

ROLLBACK THE PHASE-IN PERIOD FOR
RECOGNITION OF ACTIVE PARTICIPANTS COLA
TO REFLECT A 40-YEAR PHASE-IN PERIOD

In 1987 and 1988 as part of the original refinancing package, the cost of postretirement cost-of-living benefits began to be funded. At that point, the liabilities for retirees were fully recognized. However due to the cost impact, the liabilities for actives were to be phased in over 30 years for teachers and 25 years for PERS.

As part of the pension revaluation effective in 1990, the phase-in process was accelerated. The goal in either case was to recognize these liabilities in a rational, sound manner within the budgetary constraints. This proposal would revert to the original process using 40 years from 1987 (TPAF) or 1988 (PERS).

The resulting phase-in percentages are summarized on the next page. Note that these percentages are applied to the contribution rates to get the required contribution amounts. The second page following presents the anticipated cost impact.

PHASE-IN PERCENTAGES

Fiscal Year	1987 - 88 Refinancing		1990 Revaluation		1994 Proposal	
	TPAF	PERS	TPAF	PERS	TPAF	PERS
1989	3.33%	0.00%				
1990	6.67%	4.00%				
1991	10.00%	8.00%				
1992	13.33%	12.00%	31.25%	25.30%		
1993	16.67%	16.00%	34.50%	25.30%		
1994	20.00%	20.00%	34.50%	34.50%	20.00%	20.00%
1995	23.33%	24.00%	40.50%	40.50%	23.33%	24.00%
1996	26.67%	28.00%	46.50%	46.50%	25.66%	26.24%
1997	30.00%	32.00%	52.50%	52.50%	27.98%	28.47%
1998	33.33%	36.00%	58.50%	58.50%	30.30%	30.71%
1999	36.67%	40.00%	64.50%	64.50%	32.63%	32.94%
2000	40.00%	44.00%	70.50%	70.50%	34.95%	35.18%
2001	43.33%	48.00%	76.50%	76.50%	37.27%	37.41%
2002	46.67%	52.00%	82.50%	82.50%	39.60%	39.65%
2003	50.00%	56.00%	88.50%	88.50%	41.92%	41.88%
2004	57.33%	60.00%	94.50%	94.50%	44.24%	44.12%
2005	56.67%	64.00%	100.00%	100.00%	46.57%	46.35%
2006	60.00%	68.00%	100.00%	100.00%	48.89%	48.59%
2007	63.33%	72.00%	100.00%	100.00%	51.21%	50.82%
2008	66.67%	76.00%	100.00%	100.00%	53.54%	53.06%
2009	70.00%	80.00%	100.00%	100.00%	55.86%	55.29%
2010	73.33%	84.00%	100.00%	100.00%	58.18%	57.53%
2011	76.67%	88.00%	100.00%	100.00%	60.51%	59.76%
2012	80.00%	92.00%	100.00%	100.00%	62.83%	62.00%
2013	83.33%	96.00%	100.00%	100.00%	65.15%	64.24%
2014	86.67%	100.00%	100.00%	100.00%	67.47%	66.47%
2015	90.00%	100.00%	100.00%	100.00%	69.80%	68.71%
2016	93.33%	100.00%	100.00%	100.00%	72.12%	70.94%
2017	96.67%	100.00%	100.00%	100.00%	74.44%	73.18%
2018	100.00%	100.00%	100.00%	100.00%	76.77%	75.41%
2019	100.00%	100.00%	100.00%	100.00%	79.09%	77.65%
2020	100.00%	100.00%	100.00%	100.00%	81.41%	79.88%
2021	100.00%	100.00%	100.00%	100.00%	83.74%	82.12%
2022	100.00%	100.00%	100.00%	100.00%	86.06%	84.35%
2023	100.00%	100.00%	100.00%	100.00%	88.38%	86.59%
2024	100.00%	100.00%	100.00%	100.00%	90.71%	88.82%
2025	100.00%	100.00%	100.00%	100.00%	93.03%	91.06%
2026	100.00%	100.00%	100.00%	100.00%	95.35%	93.29%
2027	100.00%	100.00%	100.00%	100.00%	97.68%	95.53%
2028	100.00%	100.00%	100.00%	100.00%	100.00%	97.76%
2029	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%

ESTIMATED ANNUAL SAVINGS *

FOR PROPOSAL 4

	FY '94	FY '95	FY '96	FY '97	FY '98
PERS State	\$ 8	\$ 10	\$ 12	\$ 14	\$ 16
TPAF	25	78	41	50	59
Total	\$ 33	\$ 88	\$ 53	\$ 64	\$ 75
PERS Local	\$ 57	\$ 62	\$ 67	\$ 72	77

* Proposal #4

Modify the phase-in recognition of the active population cost-of-living benefits to reflect the current phase-in point from the original refinancing with approximately a 2.50% annual escalation in the future.

ITEM 5

ELIMINATE 2% MEMBER CONTRIBUTION SUBSIDY

The member contribution subsidy dates back to the 1960's when system benefits were integrated with Social Security benefits (i.e., a reduction was made to the basic benefit equal to the Social Security benefit). This approach was logical since the benefit payable from the Systems, together with Social Security benefits, would produce a desired benefit level. Since the System was offsetting a portion of the Social Security benefit from the overall System benefit, the member was not required to fund for this offset portion. When benefits payable under the System were changed to their present form which is non-integrated, the 2% subsidy for member contributions, which logically should have been eliminated, was not.

As explained above, there is no logical basis for offsetting a non-integrated benefit formula. Member contributions for other New Jersey State Systems are determined based on the actual benefits payable from those Systems and do not include a subsidy. We are unaware of any other State with a fixed benefit accrual rate (non-integrated) which uses the employee contribution subsidy.

The chart on the next page presents the anticipated annual cost impact of this proposal.

ESTIMATED ANNUAL SAVINGS FOR PROPOSAL 5

*

	'94	'95	'96	'97	'98
PERS STATE					
Current	148.4	198.5	233	260	280
Revised	148.4	162.5	194	218	235
Savings	N/A	36	39	42	45
TPAF					
Current	380.5	585.0	725	815	896
Revised	380.5	523.0	650	735	811
Savings	N/A	62.0	75	80	85
PERS LOCAL					
Current	138.6	191.3	225	252	280
Revised	138.6	159.3	191	216	242
Savings	N/A	32	34	36	38

* Proposal #5

Eliminate the 2% member subsidy on required contributions up to the Social Security wage base limit.

ITEM 6

**MODIFY EXPERIENCE RECOGNITION PERIOD FROM
TWO TO FIVE YEARS (TPAF ONLY)**

As required by statute, the valuation assumptions are reviewed every three years in light of actual system experience. Based on this review, the funding course is "corrected" to better reflect the anticipated system commitments. One such change which is made periodically is an update to the post-retirement mortality tables to reflect the longer life expectancy of retirees. This change in the case of TPAF is anticipatory in that the present tables are resulting in only modest actuarial losses each year. This pattern will escalate over time as retirees continue to have longer life expectancies. To anticipate this pattern, a newer life expectancy table has been recommended under TPAF. Once in the past this type of change was phased in over a two-year period. The present proposal would use a five-year phase in. Presumably, this would ensure that the new table is fully reflected by the time the 1997 experience review is undertaken. It is unlikely that the 1994 review will result in an additional change in these tables, so that the timing of full recognition in 1997 is likely to coincide with the next update.

The table on the next page presents the anticipated annual cost impact of the proposal.

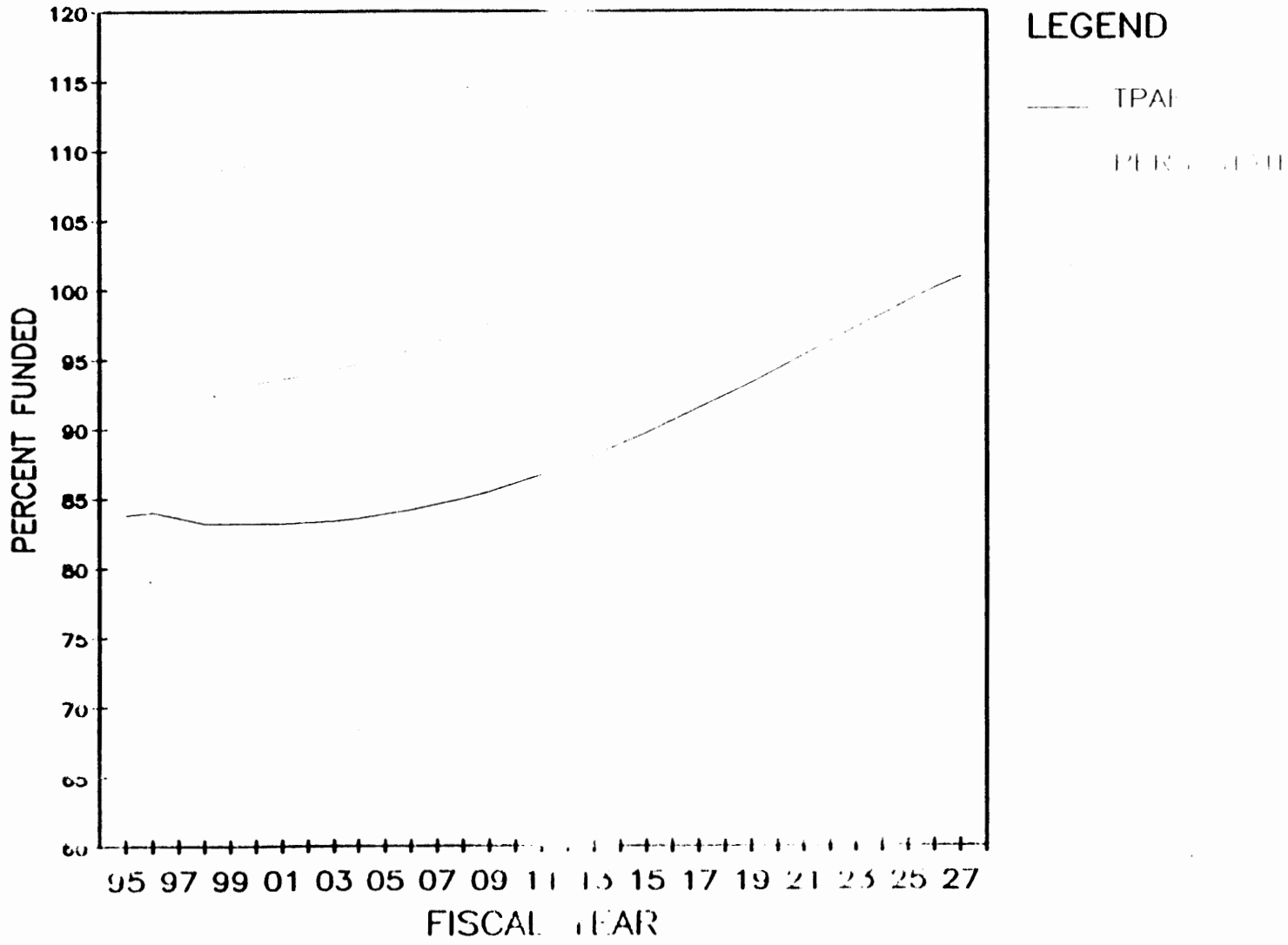
ESTIMATED ANNUAL SAVINGS FOR PROPOSAL 6 *

	'94	'95	'96	'97	'98
TPAF					
Current	380.5	585.0	725	815	896
Revised	380.5	525.0	669	775	873
Savings	N/A	60.0	56	40	23

* Proposal #6

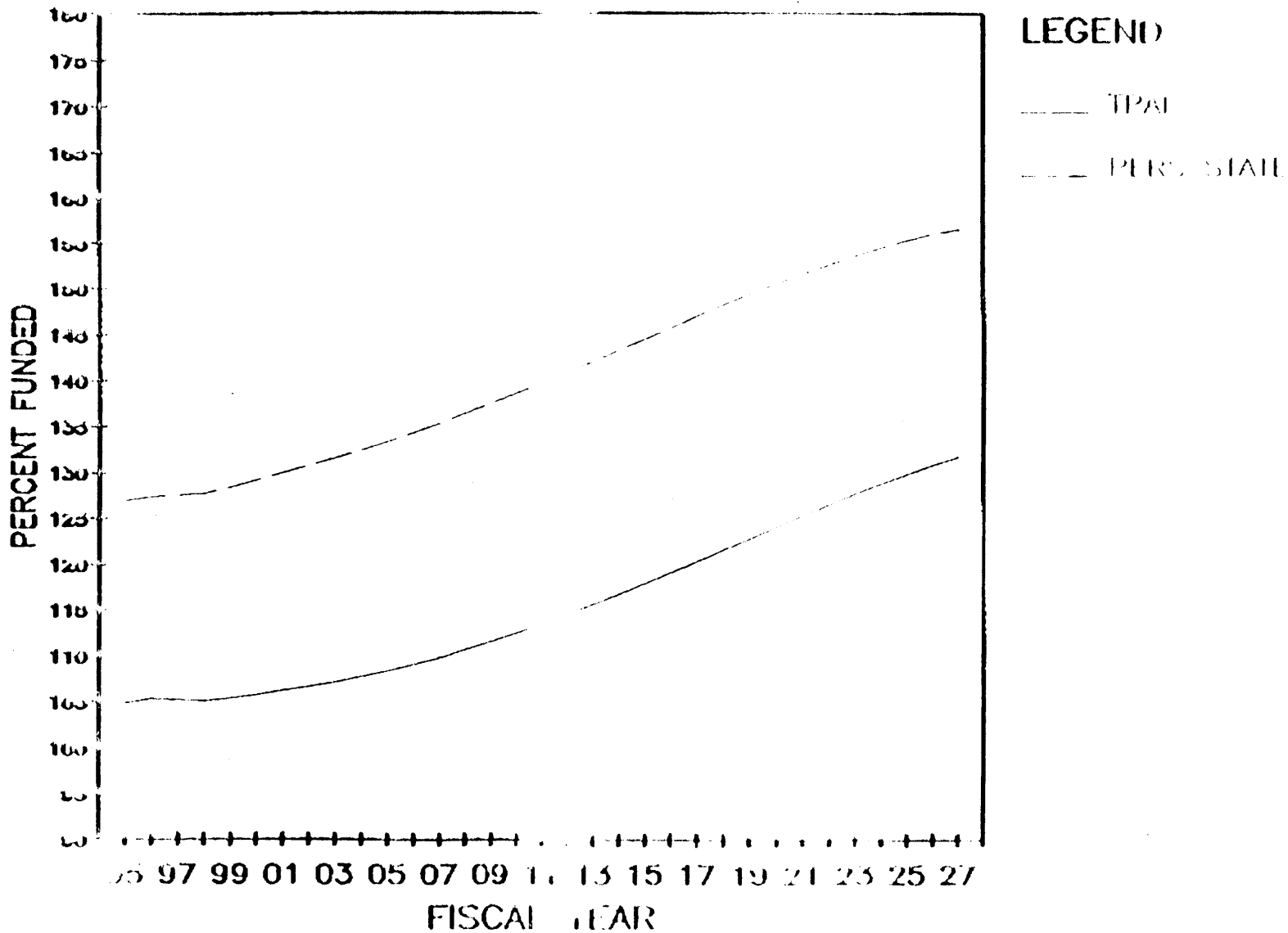
Extend the phase-in period for recognition of the latest TPAF
experience changes from two to five years.

STATE OF NEW JERSEY ANTICIPATED PBO FUNDED RATIOS UNDER PROPOSED METHOD



29x

STATE OF NEW JERSEY ANTICIPATED ABO FUNDED RATIOS UNDER PROPOSED METHOD



30X

PENSION REFORM PROPOSAL

Questions and Answers

I. ELIMINATE THE PRE-FUNDING OF POST-RETIREMENT MEDICAL BENEFITS

1. WHY SHOULD PRE-FUNDING OF POST-RETIREMENT MEDICAL BENEFITS BE ELIMINATED NOW?

It should first be noted that the current policy of funding post-retirement medical benefits was adopted by New Jersey at a time when virtually no one else was funding these benefits. New Jersey has been one of the leaders in this respect. This policy was enacted because of the size of the liabilities involved and the potential for significant continued escalation of costs in the future. At that time, this was a very responsible decision to make.

The lack of funding elsewhere is readily attributable to Federal restrictions (in the private sector) and budgeting constraints, as well as a lack of common practice, in the public sector. In fact, a recent informal survey indicated that, as of 1994, only 7 states out of 34 responding presently prefund any level of PRM benefits.

In answer to the original question, two very dramatic developments have occurred which have lessened the perceived necessity of pre-funding. The first is that medical trend rates, which had been increasing at annual rates of, for some years, over 20% have decreased to levels which in general are below 6%. In the case of the State of New Jersey's increases, the latest annual renewals for fiscal 1995 show a negative impact, i.e., reduced rates for this coverage. The second is the expected dramatic impact on the State's health coverage of the present deliberations in Washington on health care reform.

2. COULDN'T THE SHORT TERM DECREASE IN MEDICAL TREND RATES BE AN ABERRATION?

The significant change in inflation levels raises the issue of intergenerational taxpayer equity which was a keystone of the studies on funding policy produced in late 1989 and has been an important aspect of the recent changes in funding policy. The lower medical trend rates, even over a short-term period, raise a concern that the State may be over-funding for these benefits today to the disadvantage of current taxpayers. The State does not want to over budget (and over tax) today, if it leads to a windfall for future taxpayers.

Please note that the present policy has evolved over a period of time. When pre-funding was deemed to be the prudent path, it was put into law. The liabilities and costs are constantly monitored and reviewed. If the trend proves to be an aberration, our actuaries will raise this issue and suggest possible alternatives. However, at the current time, we feel confident that this is the proper course of action.

3. WHAT EFFECT WILL THE CLINTON HEALTH CARE REFORM PROPOSAL HAVE ON THE STATE'S HEALTH COVERAGE?

It is impossible to know at this point what the impact will be and how it will affect costs. Given this uncertainty, it appears appropriate to review the medical cost funding policy at this time. We feel it is appropriate to revert to pay-as-you-go funding, at least on a temporary basis, until the reform issue is clarified and we have better experience with regard to the impact on future medical inflation levels.

II. RESET THE FUNDING OF THE UNFUNDED ACCRUED LIABILITY TO 40 YEARS

4. WHY GO TO 40 YEAR FUNDING?

We are not actually "going to" 40-year funding. The current law provides that the maximum limit for funding the accrued liabilities is 40 years. The original ERISA legislation permitted 40 year funding of accrued liabilities for private plans. Forty year funding is not uncommon for other public plans.

Our proposal on accrued liability funding is that we go to 40 year funding for accrued liabilities from the year in which the major retirement systems were refinanced or revalued to provide for prefunding of COLA and PRM benefits (1987 for TPAF, 1988 for PERS and 1989 for PFRS, and 1990 for SPRS and JRS). Thus the actual remaining accrued liability funding periods for the systems affected by our proposal from fiscal year 1994 will be less than 40 years and will vary as follows: 35 for TPAF, 36 for PERS, 37 for PFRS, and 38 for SPRS and JRS. The accrued liability funding periods were dramatically shortened under pension revaluation.

The State of New Jersey and its political subdivisions are not like private businesses which may go bankrupt or out-of-business in the short term. They will be around for the long term. The retirement systems for their employees are all well funded, ranging over 80% to 96% for all the systems. The value of pension assets as of June 30, 1993 was \$36.4 billion. A 40-year funding period for the relatively small unfunded accrued liabilities (\$4.6 billion) will permit full funding of these liabilities in a manner which is stable from a budgetary perspective and equitable for taxpayers over a reasonable time period.

III. NEW ACTUARIAL FUNDING METHOD

5. WHY ARE YOU CHANGING?

The present method concentrates too much of the cost of our systems on the present - thus, overburdening the current taxpayers. Our goal is to spread the systems' costs over present and future taxpayers on an equitable basis. The new method is designed to meet this goal in a rational and sound way. The method also responds more quickly to changes in the overall workforce size.

6. WILL THIS METHOD IMPACT THE FUNDED LEVEL OF THE SYSTEM? OR WILL THIS METHOD IMPACT THE SECURITY OF RETIREES' BENEFITS?

The systems have sufficient funds to pay benefits for many years. The old policy would have continued to produce cash flows in excess of payouts. The new policy will still generate positive cash flows though not to the extent that the old policy would have.

Why use funding levels?

Both public and private pension plans are required by various regulatory bodies to make certain standard disclosures pertaining to the financial condition of the plan. They generally require these disclosures to be made under the same principles of accounting to facilitate the comparison of one plan to another. Included in these disclosure requirements is a relevant bit of information known as the "funding level."

The funding level, at a glance, reveals level of assets that has been accumulated to date, that, if a plan were to be suddenly terminated, could be used to satisfy the pension liability that has accrued to date.

Kinds of funding levels.

To facilitate the comparison to other retirement systems, two methods of computing the funding level, one required by Statement No. 5 of the Governmental Accounting Standards Board, and the other required by Financial Accounting Standards Board Statement No. 87, are included in the valuation reports of all New Jersey's state retirement systems.

Statement No. 5 of the Governmental Accounting Standards Board (GASB), issued November, 1986, establishes the standards of disclosure of pension information by **public** retirement systems. One of the requirements set forth in this statement is the disclosure of the public system's Pension Benefit Obligation (PBO). Simply stated, the PBO represents the total accrued pension liability based on the ratio of a members actual years of service rendered over total projected years of service to be rendered.¹ This method of pension liability computation takes into consideration the on-going nature of a governmental entity and takes into consideration **future** salary increases. A PBO funding level percentage is developed by taking the ratio of the pension system's assets over the PBO.

An alternate measure of level of funding is computed based on Financial Accounting Standards Board Statement (FAS) No. 87. This is a standard level of funding disclosure required by all **private** sector pension plans and is, therefore, a more universal form of measure that could be used when comparing one pension plan to another. Where GASB #5 requires the calculation of a pension system's PBO, FAS No. 87 requires the disclosure of the system's Accumulated Benefit Obligation (ABO). The ABO is computed on the same basis as the PBO except for one difference, i.e., the ABO does not take into consideration future salary increases when computing the total accrued pension liability to date.¹ The ABO funding level is developed by taking the ratio of the pension system's assets over the ABO.

The difference between funding levels.

As previously mentioned, the major difference in both funding level computations is that the PBO takes into account future assumed salary increases, while the ABO does not. The PBO reflects the on-going nature of a governmental entity. However, if a plan were to be suddenly terminated, the ABO reflects more accurately the level of asset accumulation that exists at the valuation date to cover the pension system's liabilities **that have actually accrued to date.**

The following is a comparison of the PBO and ABO funding levels of New Jersey's Public Employees' Retirement System (PERS) and Teachers' Pension and Annuity Fund (TPAF), and the average PBO and ABO levels of funding as disclosed in a recent national survey of 82 state employees' and teachers' retirement systems.²

	PBO-Actual NJ	PBO-Average	ABO-Actual NJ	ABO-Average
PERS				
State	93.1%	96.0%	126.9%	108.0%
Local	96.3%	96.0%	129.9%	108.0%
TPAF	83.8%	79.0%	104.8%	89.0%

None of the proposed changes will compromise the present or future funding levels of any of the State's pension systems.

¹Under both the Pension Benefit Obligation and Accumulated Benefit Obligation, the liabilities include amounts for both basic benefits and future cost of living increases.

²1993 Report on Funding Levels for State Retirement Systems. Stephen L. Neabitt and Jeanne M. Shearer, Wilshire Associates, Inc., May 21, 1993.

7. IS THE PROJECTED UNIT CREDIT A COMMON FUNDING METHOD?

The projected unit credit is a very acceptable funding method, especially in the private sector. In fact, the vast majority of private sector plans use the projected unit credit funding method. The Financial Accounting Standards Board actually requires the use of this method for expense purposes for all private sector plans. There has been a significant increase in the number of states using this method over the last 5 years.

8. WHICH METHOD PRODUCES HIGHER CONTRIBUTIONS?

Because the entry age method recognizes expected future benefit accruals, it tends to produce a more level contribution pattern as a percentage of pay. Under the projected unit credit method, which recognizes benefits accrued to the valuation date, costs tend to escalate over time as a percentage of pay as the retirement population matures in future years.

As a result, the unit credit method generates lower costs initially, with higher costs later on when measured as a percent of pay. Since benefit accruals would expect to be generally at a higher level in later years, due to inflation, this method would result in a more equitable allocation of costs as benefits accrue. It should be noted that the new method will respond quickly to changes in workforce size.

IV. DELAY RECOGNITION OF THE IMPLEMENTATION OF THE REVISED ACTUARIAL ASSUMPTIONS FOR TPAF

9. WHY DELAY RECOGNITION OF THE REVISED ASSUMPTIONS?

Although the current legislation mandates that a three year experience study be prepared, there is precedent to delay the recognition of these results. In fact, the three year experience investigation for the period ended March 31, 1988 was not fully recognized until the March 31, 1991 valuation.

10. WILL THIS DELAY IMPACT THE FUNDED LEVEL OF THE SYSTEM?

No, not measurably. Even though legislation mandates a three year study, a five, or even, ten year study is fairly common practice. The trend that might begin to become apparent over a three year period may become more pronounced over a longer period of time or, possibly revert back to the current trend. As long as the implementation is not delayed indefinitely, the impact will be absorbed through the routine application of the funding method and funded over time.

The major assumption change impacting costs is the update to the life expectancy table. This change is in anticipation of future improvements in this regard. As such, the phase-in will tie the recognition more closely to future experience as it improves.

V. ELIMINATE THE OFFSET AGAINST MEMBER'S CONTRIBUTION EQUAL TO 2% OF THE COMPENSATION SUBJECT TO SOCIAL SECURITY TAX

11. WHY IS THIS OFFSET BEING ELIMINATED?

This offset dates back to the 1950's when plan benefits were integrated with Social Security benefits (i.e. a reduction was made to the basic benefits equal to the Social Security benefit, the logic being that the benefit payable from the Systems, together with Social Security benefits, would produce a certain benefit level. Also, since the System was not providing the Social Security portion of the benefit, the member should not be funding it as well). When benefits payable under the System were changed to their present form, the 2% offset to member contributions, which logically should have been eliminated, was not.

12. DO ANY OTHER STATE SYSTEMS OFFSET MEMBER CONTRIBUTIONS?

As explained above, there is no logical basis for offsetting a non-integrated benefit formula. Member contributions for other State Systems were determined based on the actual benefits payable from those Systems. We are unaware of any State with the fixed benefit accrual rate (non-integrated) which uses the employee contribution offset.

VI. GENERAL

13. WHY MAKE THE CHANGE AT THIS TIME?

The present policy, method and assumptions, are constantly monitored and reviewed and are frequently changed when situations warrant. A current analysis indicates that, for the reasons given previously in regard to each proposed change, this is an appropriate time to reevaluate and fine tune the System's funding policies and designs.

14. SUPPOSE IT DOESN'T WORK?

Nothing is set in stone. If the changes do not measure up or if the medical trend begins to escalate or if any of the components appear to be out of line, our actuaries will raise these issues and corrective steps will be taken as they have in the past.

15. CAN YOU GUARANTEE THE SYSTEMS WILL NOT RUN OUT OF MONEY?

Keeping in mind that the funding policy - the assumptions and methods - are constantly monitored by our actuaries and other professionals, it is difficult to imagine any events which would bankrupt any one of the systems.

With FY'93 asset accumulations in the State's pension systems at over \$36 billion, as compared to over \$23 billion in FY'89, and the rate of return on pension assets as of June 30, 1993 measured at 12.5%, the pensions are in a very sound financial condition. Under the proposed changes, the pension systems will continue to experience positive cash flows and continued asset growth.

TENTATIVE AGREEMENT BETWEEN THE COMMUNICATIONS
WORKERS OF AMERICA, AFL-CIO, AND THE STATE
OF NEW JERSEY FOR COLLECTIVE NEGOTIATIONS
AGREEMENTS, JULY 1, 1992 THROUGH JUNE 30, 1995

A. SALARY AND COMPENSATION

1. The parties agree that subject to the State Legislature appropriating funds there shall be:
 - a. A five percent across-the-board salary increase effective on or about October 1, 1993; and
 - b. A six percent across-the-board salary increase effective on or about July 1, 1994.

B. CLOTHING ALLOWANCE

1. Effective on or about July 1, 1994, 700 additional employees in CWA negotiations units, occupying titles not currently receiving clothing allowance payments, will receive such payments.
2. The criteria contained in the 1989 fact-finder's report with respect to clothing allowance payments will be used by the parties to identify additional clothing allowance eligible titles.
3. Absent agreement by the parties on clothing allowance eligible titles, by January 1, 1994 the parties will

submit this dispute to binding arbitration in accordance with the contractual arbitration procedure. The arbitrator shall designate titles to be eligible for receipt of clothing allowance payments beginning on or about July 1, 1994 based upon the criteria in the 1989 fact-finder's report and based upon the parties' agreement that 700 additional employees in CWA negotiations units will receive such payments.

4. Effective on or about July 1, 1994, clothing allowance payments will be increased to \$550.00.

C. EDUCATION SUPERVISORS I

1. On or about July 1, 1994, Education Supervisors will receive a two-range salary increase.
2. Education Supervisors will be placed on their new range in the same step that they occupied in their old range.

D. ADVANCED DEGREE STIPEND PROGRAM FOR TEACHERS

1. Effective July 1, 1992, all teachers will receive a stipend for Master's Degrees in the amount of a one-step increase on their salary range. All teachers with Master's Degrees shall receive these stipends, including

teachers at the maximum step of their salary range.

E. LATENESS POLICY

1. The following side letter will be added to the contract:

When an employee is late for work due to dependant care problems, it is the position of the State that the employee and the supervisor/manager at the employee's work site, will meet to try to resolve the lateness problem. The employee will have the right to union representation during this meeting. This meeting will be held prior to any disciplinary action being taken against the employee as a result of the lateness. However, once such a meeting is held, the State reserves its right to implement disciplinary action if the employee continues to come in late for work.

For the State

For the Union

Date

F. HEALTH AND SAFETY

1. Department-wide health and safety committees, which were established on an experimental basis shall become

permanent.

2. All departments shall establish department-wide health and safety committees.
3. The State-wide health and safety committee shall consider recommendations for new or revised health and safety standards developed by either the Union or the State.
4. Notice of proposed work-site relocations or renovations shall be provided to the Union. The State agrees to meet with the Union concerning the impact of such relocations and renovations upon health and safety conditions and other terms and conditions of employment.

G. ORIENTATION SESSIONS

1. In all departments the State will provide a 30-minute period during new employee orientation sessions to allow a non-State employee Union representative to meet with new employees and explain the Union's responsibilities.
2. If a non-State employee Union representative cannot be present during an orientation session, a unit employee designated by the Union will be allowed to make such a presentation.

H. UNION LEAVE

1. All employees currently holding full-time elected or appointed positions with the Union shall be permitted to remain on leaves of absence without pay for the duration of the collective bargaining agreement.

I. UNCLASSIFIED AND PROVISIONAL LANGUAGE

1. The parties agree that phrase "job classification" as used in the Layoff and Recall Article for unclassified and provisional employees shall encompass all titles within a titles series and layoffs will be based upon total seniority within job classification, in accordance with the terms of paragraphs a(4) and (5) of the Article.
2. Unclassified and provisional employees shall be given a generalized layoff notice of 45-days.
3. Unclassified employees not covered by statutory disciplinary procedures, who have served in unclassified titles for a minimum of six consecutive years may appeal major discipline in accordance with the procedures in Article V para. J(5).
4. Unclassified and provisional employees will have the

right to utilize contractual minor disciplinary appeal procedures on the same basis as career service employees.

J. PART-TIME, INTERMITTENT, TEMPORARY AND SPECIAL SERVICES EMPLOYEES

1. Within sixty days of the execution of the collective negotiations agreements the State and the Union will constitute a labor-management committee for the purpose of reviewing the status of non-negotiations unit employees performing the same or similar duties as employees represented by CWA. A representative from DOP will participate on the committee. The committee shall be comprised of equal numbers of union and management representatives and will develop standards to determine which part-time, intermittent, temporary and special services employees, not presently included in CWA's units, should be included.

K. PUBLIC ADVOCATE

1. The State agrees to withdraw the scope of negotiations petition challenging the negotiability of job security and layoff provisions for ADPAs and ADPDs employed by the Department of the Public Advocate.
2. The State agrees that all ADPAs and ADPDs shall receive

full increments (five percent of base) on their current anniversary dates. All ADPAs and ADPDs, who have anniversary dates between January 1, 1992 and the execution of this agreement, and who did not receive an increment, shall receive increments retroactive to their anniversary dates.

3. The State agrees that CWA shall have the right to designate Union stewards for the express purpose of representing ADPAs and ADPDs. Such stewards will be designated in accordance with the parties' existing practices.
4. The Department will evaluate the performance of ADPAs and ADPDs utilizing PAR procedures as set forth in the collective negotiations agreement and in DOP rules and regulations.
5. The State and the Union recognize that disputes continue to exist with respect to the placement of ADPAs and ADPDs on correct steps of the applicable salary ranges and with respect to the establishment of correct anniversary dates for ADPAs and ADPDs. For purposes of resolving these disputes the parties agree to meet prior to September 1, 1992. If the parties are unable to reach agreement, the disputes will be appealed in accordance with contractual

procedures.

L. HRDI

1. The parties agree that CWA will continue to represent all HRDI employees and positions presently represented by the Union, and which are the subject of the pending clarification of unit petition before PERC.
2. The State agrees to withdraw the pending clarification of unit petition and to take all necessary steps to insure that HRDI employees will continue to be eligible for union representation.

M. COST CONTAINMENT

1. CWA and the State will establish a labor/management health care cost containment committee. The committee will be charged with those responsibilities outlined in the appendix to the report prepared by CWA entitled "Good Medicine".

N. PENSIONS

1. CWA will agree to support a revenue neutral pension proposal for fiscal years 1992 and 1993 which will

provide, inter alia:

- a. a ten-year phase-in of COLA;
- b. a 20-year phase-in of medical benefits; and
- c. guaranteed benefit levels.

O. PRESCRIPTION COPAYMENTS

1. CWA agrees that pursuant to the contractual prescription drug program, each prescription required by competent medical authority for Federal Legend Drugs shall be paid for by the State from funds provided for the Program subject to a deductible provision which shall not exceed \$5.00 per prescription or renewal of such prescription and further subject to specific procedural and administrative rules and regulations which are part of the Program.

P. LOUDERMILL RIGHTS

1. Language providing career service employees with "Loudermill" rights shall be incorporated into the disciplinary provisions of the contract.

Q. JOB POSTING

1. It is agreed that job posting language will be added to the contract requiring management to post notices of promotional vacancies prior to notices of such vacancies being published in newspapers or otherwise advertised outside the negotiations unit.

R. TUITION AID

1. In all departments where tuition aid programs are in effect, those programs will be made available to employees in CWA negotiations units.

S. SENIORITY LISTS

1. Upon request by the Union departments will provide seniority lists according to part-time and full-time employees.

T. NON-EXEMPT EMPLOYEES

1. An agreed upon definition of non-exempt (NE) employees shall be incorporated into the definitions section of the contract.

U. NON-DISCRIMINATION

1. Language prohibiting discrimination for sexual or

affectional orientation shall be incorporated into the contract.

V. JANUARY 25, 1991

1. All employees suspended or reprimanded in connection with their attendance at a union-sponsored rally on January 25, 1991 will have their records expunged of such discipline.

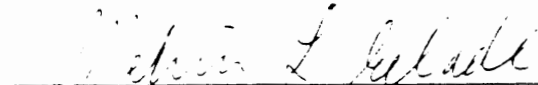
W. TERMS OF EXISTING AGREEMENTS

1. All terms of the existing collective negotiations agreements between CWA and the State, not specifically modified as a result of the above understandings, shall remain in effect and be incorporated into successor agreements from July 1, 1992 through June 30, 1995.

X. AGREEMENT SUBJECT TO RATIFICATION

1. It is understood that the terms of this agreement are subject to ratification by the bargaining committee and membership of the Communications Workers of America, AFL-CIO. It is further understood that upon ratification of the terms contained in this tentative agreement by CWA's Bargaining Committee, Union and Management representatives will meet to develop specific language for incorporation into the agreement consistent with the terms outlined above.

On Behalf of the State of New Jersey



Melvin L. Gelade, Director of Office
of Employee Relations

Dated: June 10, 1992

On Behalf of the Communications Workers of America,
AFL-CIO



Jan D. Pierce, Vice President - CWA
District One

Dated: June 10, 1992



ROBERT W PURSELL
N.J. Public Sector Director

March 17, 1994

The Honorable Christine Todd-Whitman
Governor of New Jersey
State House
CN 001
Trenton, New Jersey 08625

Re: Budget proposal concerning pension system

Dear Governor Whitman:

As you are probably aware, our Union is extremely concerned about the proposed changes to the pension system in your budget.

On 6-10-92, after months of negotiation with the State of New Jersey, our Union entered into an agreement with the State of New Jersey which provided, in part, the following provision:

- ...CWA will agree to support a revenue neutral pension proposal for fiscal years 1992 and 1993 which will provide, inter alia:
- a. a ten-year phase-in of COLA;
 - b. a 20-year phase-in of medical benefits; and
 - c. guaranteed benefit levels....

The agreement was signed by Melvin L. Gelade, Director of Office of Employee Relations on behalf of the State of New Jersey. I signed the agreement on behalf of the Communications Workers of America.

During your campaign for Governor, you issued a policy statement on labor relations which read, in part, as follows:

...Public employees and their representatives are rightly concerned about the integrity of current labor relations processes at the state level due to attempts during the last four years to unilaterally change or void negotiated agreements. Public employees should be able to expect that rights and benefits negotiated in good faith by their majority representatives can be fully and expeditiously enforced....

The budget you proposed on 3-15-94, does not provide for pre-funding of medical benefits and COLA as negotiated. The proposed

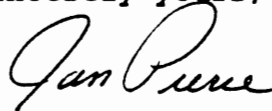
Honorable Christine Todd-Whitman
Re: Budget proposal concerning pensions
March 17, 1994 Page - 2 -

budget, furthermore, alters the existing level of benefits by eliminating the 2% pension offset. The remaining components of your budget proposal as they relate to the pension system also alter the negotiated agreement reached during the complex negotiation process in 1992.

I would like the opportunity to sit down with you and discuss this matter at your earliest possible convenience.

Thank you for accommodating this request.

Sincerely yours,

A handwritten signature in cursive script that reads "Jan Pierce".

Jan Pierce, Vice President, District One



Public employees and their representatives are rightly concerned about the integrity of current labor relations processes at the state level due to attempts during the last four years to unilaterally change or void negotiated agreements. Public employees should be able to expect that rights and benefits negotiated in good faith by their majority representatives can be fully and expeditiously enforced.

After 25 years of public sector collective negotiations, public sector employers and unions should have maximum flexibility to enter into binding agreements on all economic and non-economic subjects which intimately and directly affect employee working conditions. Such increased flexibility will facilitate the negotiations process. Moreover, government agencies which regulate state employment should not establish terms and conditions of employment through the administrative rule making process without providing public employers and unions the opportunity to consider such regulations. Wherever possible, such terms and conditions of employment should be established through collective negotiations between the union and the employer.

Additionally, a labor relations scheme which permits binding arbitration for all disputes, including discipline, will result in a savings of millions of taxpayer dollars and will permit the streamlining of bloated State personnel bureaucracy. As the courts increasingly look toward arbitration as an expedient and fair alternative to costly and time-consuming litigation, consideration should also be given to permitting public employers and unions to utilize this relatively inexpensive and binding process to settle their differences.

These proposals will foster greater dialogue, a clearer negotiations process, and more harmonious public sector labor relations.

77 BRANT AVENUE
CLARK, NEW JERSEY 07066
(908) 815-1993
FAX (908) 815-1912

~~CONFIDENTIAL~~

FOR PEOPLE FOR THE WHITMAN, WILLIAM J. MCDONNELL, CPA, TREASURER

WE'VE GOT YOU COVERED

WE'VE GOT YOU COVERED

WE'VE GOT YOU COVERED

WE'VE GOT YOU COVERED



deductions. Base salary does not include overtime, bonuses or money you receive as an adjustment before retirement. Your pension contributions are deducted from your salary each payday and reported to the PERS by your employer on a quarterly basis. If you work on a per diem basis, your employer will estimate your annual salary and deduct contributions accordingly.

Once you have been assigned a contribution rate, it is usually not changed. Buying additional service credit will not change your rate of contribution or your date of enrollment but may increase your retirement allowance (see page 20).

Entrance Age	Rate (%)	Entrance Age	Rate (%)
16	4.96%	38	6.24%
17	4.87	39	6.36
18	4.98	40	6.43
19	5.01	41	6.53
20	5.03	42	6.65
21	5.07	43	6.78
22	5.10	44	6.88
23	5.06	45	7.00
24	5.08	46	7.10
25	5.11	47	7.21
26	5.15	48	7.32
27	5.20	49	7.45
28	5.26	50	7.54
29	5.34	51	7.66
30	5.41	52	7.81
31	5.52	53	7.94
32	5.61	54	8.08
33	5.73	55	8.23
34	5.83	56	8.35
35	5.92	57	8.49
36	6.01	58	8.61
37	6.13	59 and over	8.73

Your assigned contribution rate (see chart) to the PERS is decreased by 2 percent until your base salary subject to pension reaches the maximum amount of earnings subject to Social Security Tax for that particular year. For example, if your contribution rate is 5.20%, the actual amount of your contribution will be 3.20% of your base salary until you reach the Social Security earnings maximum. After reaching the Social Security earnings maximum, contributions on salary above the maximum will be at the 5.20% rate. The maximum earnings subject to Social Security Tax change each year.

Since January 1, 1987, your mandatory pension contributions have been federally taxed deferred. Under the 414(h) provision of the Internal Revenue Code this reduces your gross wages subject to federal income tax. Purchases of service credit are voluntary pension contributions and are not subject to the 414(h) provisions.

TRANSFERS

Intrafund Transfer

If you terminate your current position covered by PERS and accept another position also covered by PERS, you may continue your membership in PERS by applying for an intrafund transfer provided:

- you have not withdrawn your membership nor has your account expired (see page 34);

THE STRONGER THE UNION...

**Communications
Workers of America
&
The State of New Jersey**

**Union Contract
for
Administrative/Clerical
Bargaining Unit**

July 1, 1992 - June 30, 1995

THE BETTER THE CONTRACT.

additional copies to the Union. The State shall distribute such copies of the Agreement to all employees in the unit and to the Union within a reasonable period of time after the Agreement has been executed. The cover of the Agreement shall include the seal of the State of New Jersey and the insignia or other appropriate designation of the unit representative.

**ARTICLE XXXIX
MAINTENANCE OF BENEFITS, EFFECT OF AGREEMENT
AND COMPLETE AGREEMENT**

A. Maintenance of Benefits

The fringe benefits, which are substantially uniform in their application to employees in the unit, and which are currently provided to those employees, such as the Health Benefits Program, the Life Insurance Program and their like, shall remain in effect without diminution during the term of this Agreement unless modified herein or by subsequent agreement of the parties.

B. Effect of Agreement

Regulatory policies initiated by the various institutions and agencies where these employees are working which have the effect of work rules governing the conditions of employment within the institution or agency and which conflict with any provision of this Agreement shall be considered to be modified consistent with the terms of this Agreement, provided that if the State changes or intends to make changes which have the effect of elimination in part or in whole such terms and conditions of employment, the State will notify the Union and, if requested by the Union within ten (10) days of such notice or of such change or of the date on which the change would reasonably have become known to the employees affected, the State shall within twenty (20) days of such request enter negotiations with the Union on the matter involved, providing the matter is within the scope of issues which are mandatorily negotiable under the Employer-Employee Relations Act as amended and further, if a dispute arises as to the negotiability of such matters, that the procedures of the Public Employment Relations Commission shall be utilized to resolve such dispute.

C. Complete Agreement

The State and the Union acknowledge this and any Memoranda of Understanding attached hereto to be their complete Agreement inclusive of all negotiable issues whether or not discussed and hereby waive any right to further negotiations except as may otherwise be provided herein or specifically reserved for continued negotiation by particular reference in memorandum of understanding pre-dating the date of signing of the Agreement and except that proposed new rules or modifications of existing rules governing working conditions shall be presented to the Union and negotiated upon the request of the Union as may be required pursuant to Chapter 303 of the Laws of New Jersey, as amended.

**ARTICLE XL
PRESERVATION OF RIGHTS**

Notwithstanding any other provision of this Agreement, the parties hereto recognize and agree that they separately maintain and reserve all rights to utilize the process of the Public Employment Relations Commission and to seek judicial review of/or interpose any and all claims or defenses in legal actions surrounding such proceedings as unfair practices, scope of negotiations, enforcement or modification of arbitration awards, issues of arbitrability, and specific performance of the Agreement.

**ARTICLE XLI
EFFECT OF LAW**

A. Legislative Action

1. If any provisions of this Agreement require legislative action, or require adoption or modification of the rules and regulations of the Merit System Board to become effective, or require the appropriation of funds for their implementation, it is hereby understood and agreed that such provisions shall become effective only after the necessary legislative action or rule modification is enacted, and that the parties shall jointly seek the enactment of such legislative action or rule modification.

2. In the event that legislation becomes effective during the term of this Agreement which has the effect of improving the wages and fringe benefits otherwise available to eligible employees in this unit, this Agreement shall not be construed as a limitation on their eligibility for such improvements.

B. Savings Clause

1. If any provision of this Agreement shall conflict with any Federal or State law or have the effect of eliminating or making the State ineligible for Federal funding, that specific provision of this Agreement shall be deemed amended or nullified to conform to such law. The other provisions of the Agreement shall not be affected thereby and shall continue in full force and effect.

2. Upon request of either party the State and the Union agree to meet and renegotiate any provision so affected.

**ARTICLE XLII
NOTICES**

For the purpose of giving notice as provided herein, the State may be notified through the Director, Office of Employee Relations, Governor's Office, 134 West State Street, CN 228, Trenton, New Jersey, 08625; and the Union through the Communications Workers of America, 10 Rutgers Place, Trenton, New Jersey 08618.

PRESENTATION
OF
CLAUDE POULIN, PENSION ACTUARY,
ON THE
NEW JERSEY GOVERNOR'S PENSION REFORM PROPOSALS

APRIL 1994

My name is Claude Poulin. I am a Fellow of the Society of Actuaries, an Enrolled Actuary under ERISA, and a consulting pension actuary for the last 25 years. I have been an actuarial trustee of the Connecticut State Employees' Retirement Commission, appointed by the Governor of Connecticut, since 1982. I was asked by the Communications Workers of America (CWA) in New Jersey to review the various elements of the Governor's so-called "pension reform proposals" and the testimonies made by several government officials as well as the State's actuaries.

Any discussion on pension reform should be predicated on the actuarial axiom that the true costs of any pension plan are represented by the benefits that will eventually be paid from the plan. No actuarial methods, assumptions or procedures ever changed the ultimate costs of a plan: they are simply tools that affect the timing of the contributions. No "pension reform" dealing with changes in actuarial assumptions, actuarial cost methods or amortization schedules ever had the virtue of bringing permanent "savings": every dollar not paid today will have to be paid later, with interest. This is as inexorable as the periodicity of the tides in the ocean. Anyone who claims a magic formula for lasting low contributions should have the same credibility as he if or she claimed that low tides will stay with us forever, and this person is likely to suffer the same fate as old king Canute.

The second point to bear in mind is specific to the New Jersey state employees retirement systems. It has to do with the fact that under the current New Jersey statute, certain pension benefits that have been accrued and are currently accruing to state employees, are not funded by the State and are treated as if they did not exist. I refer to the lion's share of the liabilities attributable to cost-of-living adjustments that have already accrued and will be payable to future state retirees. The State has not even started paying for them yet, and moreover, is not scheduled to do so until some time in the future.

This is an unusual situation. It is abnormal to ignore certain pension liabilities when it comes to funding, particularly when they are substantial. The Actuarial Standards Board (ASB) is the actuarial body that prescribes the various norms that have to be followed by practicing actuaries. Last October, the ASB published the Actuarial Standard of Practice (ASP) No. 4 entitled "Measuring Pension Obligations". This ASP No. 4 made clear that all pension liabilities must be recognized by the actuary. The first paragraph of Section 5.2.2 reads as follows: "Plan Provisions - All provisions of the plan adopted and effective on or before the start of the plan year should generally be taken into account in measuring pension obligations, as should administrative practices with respect to matters not directly addressed in the plan."

These preliminary considerations are important as they limit the latitude of those responsible for the sound management of pension plans.

The pension reform proposed by the Governor is comprised of the following elements:

- 1) Change the funding method of the retirement system from the current Entry Age Normal Method to the Projected Unit Credit Method,
- 2) Extend the period to amortize the unfunded accrued liability from the current 30-year period to a new 40-year period,
- 3) Further postpone the funding of the cost-of-living adjustments (COLA's) for active employees,
- 4) Extend the phase-in period for recognizing revised actuarial assumptions in the teachers' pension system to five years,
- 5) Increase the employee contributions to the retirement system by an additional 2% of compensation, and
- 6) Abandon the policy of partially funding post-retirement health care benefits and revert to the pay-as-you-go method.

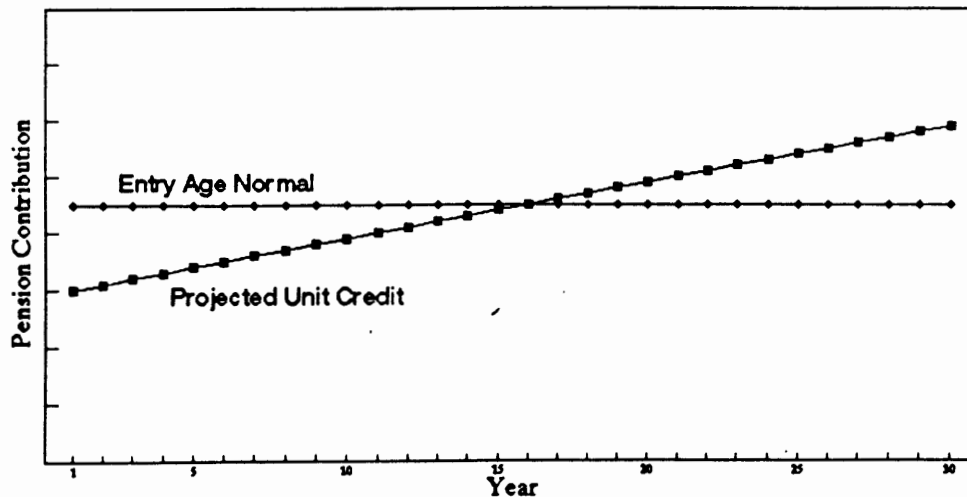
It should be noted that each and every one of these six points has the effect of "reducing" state pension contributions each year before 1999. With the exception of the cost shift to employees, each element of the reform would result in an increase in the state burden after the year 2000.

I will now address myself to the individual elements of the Governor's proposal.

1. Change the Funding Method from Entry Age Normal to Projected Unit Credit

Actuaries have at their disposal various funding or actuarial cost methods that have an impact on the incidence or timing of the employer's contributions. Two of these funding methods are the Entry Age Normal Method which is currently used by the New Jersey Retirement System and the Projected Unit Credit Method which is now proposed by the State. Without getting into the technicalities of these two methods, suffice it to say that the Entry Age Normal Method provides employer contributions that tend to be stable as a percentage of payroll, whereas costs under the Projected Unit Credit Method tend to increase over time. The following chart illustrates this major difference between the two methods:

Contributions under Entry Age Normal and Projected Unit Credit Funding Methods



58*

In 1990, the state of New York faced a budget crisis and "solved" most of its problems by legislating changes in the Retirement System's funding (Chapter 210 of the Laws of 1990). The most significant modification was a shift from the Aggregate Funding Method to the Projected Unit Credit (PUC) Method, the result of which was immediate cost reductions followed by substantial cost increases in the future. The New York State Supreme Court, the Appellate Division, and the Court of Appeals all have held, unanimously, that the funding amendments were unconstitutional.

The main points in the Court of Appeals' recent decision are:

- "...in those areas where the Legislature has some flexibility with respect to the administration of the fund, it yet remains bound by the same fiduciary duties required of any other acting in a fiduciary capacity, those of protecting the interests of the beneficiary. Here, it is uncontroverted that the only factor the Legislature considered when it chose to alter the funding method was that of the fiscal crisis facing the State."
- "...In sum, Chapter 210 impairs the benefits of the existing pension fund. Said legislation allows employers to deplete monies in the existing pension fund by reducing the amount of employer contributions. *** the reserve monies will not be available for immediate investment, the return on investment of monies in the existing fund will be significantly decreased, and the additional security provided by the reserve monies in the pension funds will be impaired."

These comments equally apply to the New Jersey proposal.

The irony of the situation in New Jersey is that the State had cost projections made showing that pension contributions will increase in the future. The "solution" proposed by the State, i.e., going to the Projected Unit Credit method, will only compound the problem. Part of the solution resides precisely in the retention of the current Entry Age Normal funding method.

2. Amortizing Unfunded Liabilities Over a 40-Year Period

At present, unfunded liabilities are funded over a 30-year period. Since this schedule was adopted three years ago, there approximately are 27 years remaining in the amortization schedule. The state proposal to amortize the unfunded pension liabilities over a 40-year period as opposed to the current 27-year period is unacceptable. First, it is a major departure from the stated policy of funding employee benefits over their working careers. While even the current 27-year amortization is longer than the average state employee's career, no one would argue that the average state employee will work for an additional 40-year period.

In his April 14, 1994 testimony, one of the state actuaries, Mr. William Reimert, quoted a portion of paragraph 107 of the Proposed Statement of the Governmental Accounting Standards Board (GASB) on Accounting for Pensions by State and Local Government Employers to justify the shift from 30 to 40-year funding.

The portion he cited reads "the existing accounting maximum of 40 years had worked well for many years and should be retained."

This excerpt is misleading when cited out of context. The full text of paragraphs 107 and 108 reads as follows:

"107. Some respondents thought that the existing accounting maximum of 40 years had worked well for many years and should be retained. Some respondents also questioned the appropriateness of any reduction in amortization periods and the resulting increase in required contributions, when many plans are well funded, funding excesses are not uncommon, and many employers are having difficulty balancing their budgets without curtailing services. However, the maximum period most frequently recommended in the responses was 30 years. Several reasons were given for recommending that period, including, for example, it is

a reasonable approximation of total service life for many employee groups and is consistent with an entry age approach to cost allocation, it is acceptable from a sound funding perspective, and it is frequently used in practice as a maximum period.

108. The Board agrees that allocating past service costs over total service life (not to exceed 30 years) is consistent with the long-term, going-concern approach adopted for this Statement. The Board has accepted a 40-year maximum for not more than ten years from the effective date of the related Statement on plan reporting, to facilitate a gradual reduction of amortization periods greater than 30 years and avoid sudden large changes in contribution rates. The Statement does not require that amortization periods be closed (declining by one year each year); therefore, an immediate or more rapid reduction of amortization periods is acceptable."

It is now clear from the above that GASB does not promote 40-year funding; it merely "accepts" it on an interim basis in order to prevent sudden large increases in state contributions. It is certainly not intended to condone the proposed instant change, especially when the current practice is already 30-year funding, or better.

Certain individuals who testified on behalf of the state cited ERISA as allowing 40-year funding. This is inaccurate. ERISA does not allow private pension plans to re-amortize their unfunded liabilities over 40 years. A 40-year schedule was only allowed for the amortization of the unfunded liabilities already existing when ERISA was first enacted in 1974. All new liabilities since then had to be amortized over 30 years. Moreover, the New Jersey Retirement System's current approach of amortizing the unfunded liabilities as a level percentage of pay as opposed to level payments (like the payment of a mortgage) is also unacceptable under ERISA. The combination of these two actuarial techniques (40-year funding and level percentage of pay) would result in serious underfunding of the retirement systems and effectively transfer the cost of

providing pension benefits to current retirees and employees to future generations of taxpayers.

3. Reduce the Funding of COLA's

Before 1987, cost-of-living-adjustments were funded on a pay-as-you-go basis, which is the euphemism for no funding at all. In 1987, the decision was made to fund the COLA throughout the retirement systems. As mentioned earlier, subsequent pieces of legislation resulted in a phase-in of the recognition of the liabilities attributable to COLA's so that for Fiscal Year 1995, only 40.5% of the liabilities attributable to cost-of-living adjustments payable to future retirees is recognized by the state actuary for state employees, while the phase-in amounts to 97% for local employers. The Governor's pension proposal intends to further reduce the phase-in to 20% in Fiscal Year 1994 and 24% in Fiscal Year 1995 for PERS (state and local employers). The following table shows the percentages in effect for the various systems under current statute as well as under the proposed legislation.

COLA Phase-In

	Fiscal Year	<u>Current</u>			Fiscal Year	<u>Proposed</u>	
		<u>1994</u>	<u>1995</u>			<u>1994</u>	<u>1995</u>
PERS							
	State	34.5%	40.5%		State	20.0%	24.0%
	Local	93.0%	97.0%		Local	20.0%	24.0%
TPAF		34.5%	40.5%	TPAF		20.0%	23.3%

These reductions in phase-in would result in the following savings for state and local employers:

	<u>Savings (in millions)</u>	
	<u>Fiscal Year</u>	
	<u>1994</u>	<u>1995</u>
State (PERS and TPAF)	\$54.9	\$121.3
Local	58.5	88.7

No rationale is offered for this proposal except that it further reduces employer contributions for the next several years and simply shifts the burden of funding already accrued cost-of-living-adjustments to future taxpayers. In my opinion, it is unacceptable. It departs from the actuarial practice --mentioned earlier -- of funding all pension liabilities provided by a pension plan. Were this proposal adopted, it would reduce the funded ratio of the retirement system and would set the stage for either reducing or eliminating future cost-of-living adjustments to state retirees.

4. Extend the Phase-In Period for Recognizing Revised TPAF Actuarial Assumptions

This proposed change purportedly affects only the Teachers' plan, but there are indications that the State may adopt the same policy for PERS state and local employers.

As a matter of fact, to the extent that the state actuary is using a much older mortality table for PERS than for the Teachers' plan, there may be an implicit understatement of pension liabilities under PERS as well.

At the present time, the statute requires that if a revision of the retirement system's actuarial assumptions, for instance a reduction in the interest rate assumption, results in an increase in liabilities, the recognition of these increased liabilities may be phased-in over a 2-year period. The State proposes to phase-in this recognition over a 5-year period instead of a 2-year period. Again, no rationale is advanced for this change except that it will save money in the short run and will, of course, increase liabilities and future state contributions in the long run. It should therefore be rejected.

5. Elimination of the 2% Employee Contribution Reduction Due to Social Security

There is no magic formula dictating the level of employee contributions in state retirement systems. The current level of contributions depends on the employee's age at entry and varies by plan. The state proposal intends to increase the employee contributions by 2%. To the extent that the average state employee currently pays slightly less than 5% of pay in pension contributions, the proposal would increase the average employee contribution by over 40%, while the state's own share drastically goes down. The rationale utilized for this proposed increase in employee contributions is that the retirement system used to be integrated with Social Security and that when this integration with Social Security was eliminated in 1966, employee contributions did not

simultaneously increase by 2%.

This rationale is weak. For instance, there could have been a quid pro quo in 1966 when Social Security integration was abandoned.

Also, many public employee retirement systems are entirely noncontributory. The most recent study of "Employee Benefits in State and Local Governments", published in 1992 by the Bureau of Labor Statistics of the Department of Labor, revealed that there were no employee contributions at all in 25% of government pension plans. Incidentally, the same study showed that in the private sector, "the full cost of defined benefit pension plans was paid by the employer for 96% of plan participants in medium and large establishments in 1989."

The Governor's proposal with respect to employee contributions would only result in further transferring the cost of the pension system from the State to its employees who are already paying more than their employer toward their retirement benefits.

6. Eliminate the Funding of Post-retirement Health Care Coverage

Eliminating the funding of post-retirement medical benefits is the element of the pension reform proposal that would provide the largest immediate reduction in state contributions, \$268 million in 1994 alone. It does not affect pension benefits per se, but retirees' medical benefits. The pension revaluation package adopted in 1992 changed a number of aspects of the then existing funding policy with respect to retiree medical coverage. Among the changes was an acceleration of the recognition of the active employees post-retirement medical (PRM) liability to 31 1/4% with anticipated increases

over two years to 56% in 1993 after which the phase-in was to accelerate 4% per year to 100% to 2004. However, chapter 8 of Public Law 1993 reduced this schedule to 34 1/2% in 1992, escalating 6% per year to 100% in 2003. This schedule is currently in effect with the latest actuarial valuation (as of March 31, 1993) using a 40 1/2% phase-in factor. The recent state proposal is to eliminate funding of the post-retirement medical benefits altogether and to revert to pay-as-you-go funding of this benefit.

The first rationale invoked for this change is the uncertainty attributable to the debate in Washington on health care reform. There is certainly uncertainty with respect to the nature and the components of any health care reform that will take place. However, what is certain is that health care costs for retirees are here to stay and their financing will have to be provided. Usually, when faced with uncertainty, actuaries tend to be conservative and assume a worst case scenario. To use this uncertainty to eliminate any form of prefunding is hard to understand. The second rationale utilized by the Administration is that the rate of increase in medical care premiums has abated somewhat in the last few years. Again, there is no relationship between the reason invoked and the proposal to eliminate prefunding. As was pointed out in the analysis of the Governor's pension funding proposal prepared by the Office of Legislative Services (OLS) of the New Jersey Legislature in April 1994, "a decrease in medical inflation is not usually accepted as a reason for adopting a pay-as-you-go funding methodology versus prefunding." The OLS is charitable. What it really means is that this rationale does not make sense. If in fact the medical care inflation assumption needs to be revised downward, then it should be, so as long as the other actuarial assumptions are also

revised including the interest rate assumption and the mortality table currently used by the retirement systems. In this case, eliminating prefunding of retiree health care is tantamount to "throwing the baby with the bath water."

Once again, this change would create an immediate windfall to the State, while making it more difficult in the future to meet the costs of retiree health care.

In his testimony, state treasurer Brian W. Clymer mentioned that the State was guided by six principles (and then he went on and enumerated the following five):

- 1) "That not a penny's worth of the more than \$30 billion worth of assets in the State's pension funds should be touched;"
- 2) "That the benefits provided to our retirees or their survivors should not be altered;"
- 3) "That the actuarial assumptions which determine our contributions levels should be reflective of current economic conditions, budget trends and policy changes;"
- 4) That one-time savings should be avoided;
- 5) "That any change should be in accordance with accepted actuarial practice."

These statements are highly misleading. Since the state contribution for the current year will be drastically reduced, it will follow that the assets in the pension funds will also be reduced. As we have seen, this was also the opinion of the New York Court of Appeals. Similarly, the reference to actuarial assumptions being reflective of current economic conditions ignores the most important assumption, i.e., the interest rate assumption, which at 8 3/4% certainly does not appear to be "reflective of current economic conditions." Moreover, the 5-

year delay in the recognition of revised actuarial assumptions flies in the face of this virtuous-sounding principle.

There is some irony in the statement that one-time savings should be avoided since this is precisely what the State will be doing this year, by using the assets already accumulated in the post-retirement health care funds.

And finally, we have seen that "accepted actuarial practice" requires recognition and funding of all pension benefits." It does not sanction the actuarial legerdemain proposed by the State.

State Treasurer Clymer made much of the fact that "New Jersey's pension systems are in exceptionally well condition" and that the funded ratios are even approaching 100%. The only problem is that his numbers are based on a dubious assumption, i.e., that all pension liabilities could be purchased based on an interest rate assumption of 8 3/4%.

As the State actuary, Robert Baus of Buck Consultants, indicated on the cover page of the 1993 Actuarial Valuation Report on PERS, the interest rate assumption used in determining the liabilities of the System was dictated by the State Treasurer "in accordance with a directive... issued in 1992." In other words, unlike the situation under ERISA, where the interest rate assumption selected by the actuary for a private pension plan must represent his or her best estimate of anticipated experience, the New Jersey State actuary does not enjoy this latitude and must compute the pension liabilities using an arbitrary interest rate assumption. In 1992, a "Survey of Actuarial and Investment Practices of State Employees Retirement Systems" was performed by Paul Zorn, a consultant for the Government Finance Officers Association. The survey revealed that 84% of State Employees Retirement Systems used an interest rate of less

than 8.5% and only 4%, an interest rate assumption exceeding 8.99%.

A more appropriate measure of the actual funded ratio may be found in the PERS 1993 actuarial report. On the basis of the Buck Forward Interest Rate Index where the rates were 7.9% in 1992 and 6.9% in 1993", the 1993 percentage funded would be 75.2% for State and 77.8% for Local while the 1992 percentage funded would be 80.2% for State and 88.9% for Local." (See page 38 of PERS 1993 Actuarial Report.) It is important to note that under this measure, the funded ratios went down from 1992 to 1993.

There is no question that the investment experience of the last several years has been favorable. It is well documented that this was attributable, however, to a general reduction of interest rates in the economy. Similarly, we all know that the trend started reversing itself last December, and pension funds have lost billions of dollars as interest rates have been inching up in the first months of this year. These economic phenomena should be first recognized and then factored in in any discussion on pension funding.

If one subscribes to the actuarial axiom that I cited at the beginning of my presentation to the effect that the true costs of a pension plan are not altered just by altering the actuarial assumptions, then it should be obvious that the Governor's pension reform proposal will only exacerbate the pension funding problem for future legislators and taxpayers.

If this set of proposals is adopted, New Jersey will have gone, in just a few short years, from one of the more enlightened pension funding policies to one of the worst, and more importantly, to one of the most irresponsible.



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May 9, 1994

By FAX

Mr. Alan Kaufman
Staff Representative, CWA
CWA - State of New Jersey
10 Rutgers Place
Trenton, New Jersey 08618

Re: PERS Funding Level - Questions and Answers

Dear Alan:

Following, you will find the answers to the questions that were raised with respect to the funding situation of PERS.

1) Q: Would the Whitman proposal meet the standards established by ERISA to protect private sector pension plans?

A: No, it would not. The funding requirements of ERISA do not allow amortizing unfunded liabilities over 40 years, nor would they allow the delayed recognition of COLA liabilities. Moreover, the fiduciary requirements of ERISA make clear that fiduciaries' decisions should be made in "the best interests of plan participants" and not to help the employer solve budgeting problems.

2) Q: What would be the funding status of PERS if it were regulated by the standards applied to protect the integrity of private sector pension plans?

A: It would be underfunded. Private defined benefit pension plans must pay a premium each year to the Pension Benefit Guaranty Corporation (PBGC), based on the level of underfunding of the plan. To determine a plan's funded status, the PBGC stipulates the interest rate that must be used in the calculation of the present value of vested benefits. This interest rate decreased from 5.95% for January 1993 to 4.97% for December 1993.

Actuaries and Employee Benefit Consultants

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Mr. Alan Kaufman
May 9, 1994
Page 2 of 2

In other words, the rates for 1993 were much lower than those under the Buck Forward Interest Rate Index, which for 1993, yielded an interest rate of 6.9%. The New Jersey state actuary mentioned in the PERS 1993 Actuarial Report that based on that interest rate of 6.9%, "the 1993 percentage funded would be 75.2% for State and 77.8% for Local". It is then reasonable to conclude that, for PBGC purposes, the funded ratio of PERS would have been substantially lower than 75% in 1993.

3) Q: Is the PERS plan a particularly well funded plan as compared to those in other states?

A: At the present time, the level of funding of the New Jersey PERS plan is about average when compared to other states. According to a study of 82 State Retirement Systems performed by Wilshire Associates in 1993, New Jersey PERS ranks 35 out of 82 on the ABO basis, i.e., slightly better than the average State plan, but it ranks 48 out of 82 on the PBO basis, i.e., slightly worse than the average State plan (see attached Appendix D).

I will be pleased, Alan, to discuss these answers with you at your earliest convenience.

Sincerely,



Claude Poulin
Fellow, Society of Actuaries

Enclosure

F-94-047



Poulin Associates, Inc.

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**APPENDIX D
(Continued)**

**Summary of Retirement System Funding Levels
for 82 State Retirement Systems
(\$ in Millions)**

Uniform State Assumptions

Name	Excess Assets		Excess Assets		Assets as %		Assets as %	
	vs. ABO	Ranking	vs. PBO	Ranking	of ABO	Ranking	of PBO	Ranking
Kansas PERS	\$ 1,034	14	\$ 629	12	137%	7	119%	9
Kentucky PERS	245	29	2	23	113	24	100	23
Kentucky Teachers	-495	57	-1,145	56	91	51	81	50
Louisiana PERS	-1,568	70	-2,201	67	65	71	57	71
Louisiana Teachers	-3,665	77	-4,412	76	56	76	51	76
Maine PERS	-565	58	-676	48	56	75	52	75
Maine Teachers	-1,126	65	-1,340	59	42	79	38	79
Maryland PERS	218	31	-100	28	105	32	98	24
Maryland Teachers	-1,434	67	-2,164	65	86	60	80	54
Massachusetts PERS	-2,439	74	-3,327	73	61	72	53	73
Massachusetts Teachers	-3,837	79	-5,079	77	51	77	44	77
Michigan PERS	-487	56	-1,121	55	91	52	81	51
Michigan Teachers	-6,589	81	-9,904	81	71	69	62	70
Minnesota PERS	23	36	-326	38	101	36	88	37
Minnesota Teachers	-81	44	-1,001	50	99	40	87	41
Mississippi PERS	-640	60	-1,318	58	90	54	82	49
Missouri SERS	307	26	-143	31	117	20	94	29
Missouri Teachers	484	19	-182	33	109	26	97	26
Montana PERS	-11	40	-162	32	99	39	87	39
Montana Teachers	-292	52	-457	43	77	66	68	66
Nebraska Teachers	-69	43	-123	30	94	47	90	31
Nevada PERS	-178	46	-520	45	96	44	88	36
New Hampshire PERS	-7	39	-93	26	99	41	85	44
New Hampshire Teachers	35	35	-94	27	106	30	87	40
New Jersey PERS	329	25	-2,197	66	104	35	82	48

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"News"

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Contact Lynn Maher
Karen Joseph

For Immediate Release
May 18, 1994

State Treasurer Misinforms Legislature on NJEA Plans Clymer Delivers Irrelevant, Irresponsible Testimony

Trenton, NJ - NJEA President Dennis Testa today repudiated State Treasurer Brian Clymer's statement at a joint hearing of the legislative appropriations committees. Clymer asserted: "One union has boasted that it will raise and spend ten million dollars to defeat our agenda to reduce State spending and cut state taxes....I hope the Legislature can resist a two-year, \$10 million public relations campaign designed to scuttle a tax reduction program..." Previously, the administration has claimed NJEA is launching a \$10 million public relations campaign against its policies.

"The state treasurer is no spokesperson for NJEA," said Testa. **"NJEA has launched no \$10 million public relations campaign against the governor's tax cut and has no plans for such a campaign."**

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Testa added that, in the future, he hopes NJEA's policy making body, the Delegate Assembly, will consider a proposal to better acquaint the public with the achievements of public education. "New Jersey students rank near the very top nationally on both math and reading scores. Seventy-six percent of our seniors take the SAT and New Jersey is number one in the country for the number of teachers, schools, and students participating in the Advanced Placement program. We need to ensure that the public is familiar with the achievements of public education. Why would the treasurer react so defensively to proposed plans for such a positive effort?" said Testa.

"It is irresponsible of the treasurer to concoct a campaign that does not exist," Testa continued. "Moreover, his comments interfere in the internal affairs of a private, nongovernmental association; were inappropriate to present in that legislative forum; and are irrelevant to the issue at hand--the state budget.

"Finally, Clymer's comments compound a misstatement made by the administration earlier this week when it asserted that NJEA operates with public money. This is preposterous," Testa said. "Under IRS regulation, we are a private, not-for-profit corporation. We neither receive nor spend a penny of tax money.

"NJEA has worked to advance public education in New Jersey since 1853. Some NJEA leaders have worked with six governors and their administrations. No one affiliated with this organization can recall a state treasurer who has so flagrantly misrepresented facts." Testa concluded. ###

ACTUARIAL SCIENCES ASSOCIATES**COMMENTS ON PROPOSED CHANGES TO THE TPAF PENSION SYSTEM**

Actuarial Sciences Associates (ASA) has reviewed the pension system changes proposed for TPAF by the State Treasurer. Our initial findings were sent to the NJEA on April 11th. This statement supplements the items noted in that letter.

ISSUES*Deferral of costs*

We have roughly estimated the effects of this proposal on the TPAF over the next 20 years. On the basis we believe most similar to that used by the State's actuary, in each of the next 12 years, the proposal fails to set aside enough funds to cover the cost of benefits to be earned during that year, much less interest on prior years' underfunding. As an analogy, think of the pension system as a credit card; the State won't even be paying the full cost of its current purchases until 2006, and won't be paying off current purchases plus interest throughout the entire 20 year period. This is without even considering the cost of retiree medical benefits.

The largest deferral of costs is for retiree medical benefits. The proposed method does not appear to meet criteria established by the State's actuary for setting a reasonable funding target in its December 1, 1989 study (State of New Jersey Pension Funding Policy) performed for the State. In its 1989 Study, the State actuary lists two ways to test benefit security of a system (based on assets exceeding either accrued benefit liabilities or X years of future benefit payments), neither of which is met by the State proposal to cease advance funding of retiree medical benefits.

Employee contribution increase

Based on the numbers provided by the State's actuary, during fiscal 1995 member contributions would be increased to approximately \$300 million. This compares with a State contribution of only \$54 million. Thus the employees are expected to contribute at about 6 times the rate that the State contributes for fiscal 1995. Based on projections initially completed by the State actuary, and assuming 6% growth in employee pay, teachers would contribute more than the State each year through 2007.

Note that members would continue to be required to contribute on a level percentage of pay basis, even though the State was funding on a non-level basis under which earnings on employee contributions further serve to reduce State contributions.

Recognizing new mortality over 5 years

Extending the period to fully recognize the new updated mortality table from 2 years to 5 years also acts to defer costs.

Insufficient analysis of proposal effects

The initial set of projections that were supplied to NJEA by the State were clearly erroneous. The State's actuary has provided revised projections to the State and will be providing revised projections to NJEA. To date, all projections were performed on the basis of simplified techniques. These techniques are problematic in this particular instance, since they are based on implicit relationships which are not constant over time. We believe the current methods overstate the projected costs under the current plan and, likely understate the projected cost under the proposed plan.

To truly understand the effects of this significant a change in method, it is more appropriate to use more sophisticated modeling techniques which project the actual likely population, and which can be modified to reflect alternate population scenarios. These techniques are available to the State; indeed both we and the State actuary used these techniques in our 1989 studies that led to the recommendation that the State move to a market-related asset value.

We believe that the State needs to get decision-making data of a quality similar to that which backed up the asset revaluation. The simplified models used to date can be misleading. We strongly recommend that better projections be procured.

Implications of deferring State contributions

The program as stated is almost entirely a *deferral* of costs. The changes proposed by the State purport not to reduce ultimate benefit payments; instead they reschedule and reallocate costs. Some costs are reallocated to employees, by increasing the employee contribution by approximately 50%. However, the majority of costs are simply put off into the future. In essence, then, most of the State program is a program to borrow money from the pension trust, by reducing current and near term contributions and increasing far off ones.

Given that the State has determined to borrow money, it is not clear that the pension funds are the least expensive source of funds. The pension plan assets are assumed to earn at a rate of 8.75%; this means that borrowing from the pension plan is at a rate of 8.75%. This is high compared to the costs of actually borrowing in the financial markets which currently run between 6.0% to 6.5%.

CLARIFICATIONS

Finally, we note that a number of arguments have been advanced in support of the proposed changes which are not entirely accurate. To ensure that the issues are understood equally by all parties, a partial list follows:

Are pension contribution subsidies unique to NJ? According to a study just issued by Workplace Economics Inc., the states of Illinois and Oregon pay the full employee contribution and the state of Wisconsin pays the first 6% of salary of the employee contributions.

How well funded is TPAF compared to other Teacher's Plans? The ratio of the accrued benefit obligation to the assets for TPAF has been estimated by the State actuary as 104.8%, based on the assumptions used to fund the TPAF. This is above the national average of 89% from the 1993 Wilshire survey of plans, measured on each of their own assumptions. We estimate that if we adjusted the assumptions to a comparable basis, the Accumulated Benefit Obligation (ABO) ratio for TPAF would decline significantly. It should be noted that the numbers used for New Jersey in the Wilshire survey are older than for most systems (6/30/90, before changes due to the pension revaluation). Thus, it isn't at all clear that TPAF is currently better funded than the average teacher's system.

How does the funding of benefits compare with the private sector? The plan is significantly less well funded than most private sector plans, indeed were it a private sector plan, it would have a level of and underfunding comparable to plans identified by the Pension Benefit Guaranty Corporation (PBGC) in their top 50 underfunded pension plans list. It should be noted, however, that the plan has different benefit commitments and employee contribution requirements than the typical private sector plan.

Do the changes in funding achieve tax equity? Tax equity refers to the concept that each generation of taxpayer should pay the costs of services that it receives and not prepay costs attributable to future years or defer costs that are attributable to their own generation. Pension and retiree benefits represent deferred compensation; they are earned in exchange for the provision of services. Under the proposed plan, funding over the next two years will be substantially less than future or past years. Also, in future years contributions will rise steadily as a percentage of payroll.

Is the 40 year amortization period in accordance with ERISA? Public plans are not subject to the funding standards of ERISA. Private plans, which are subject to ERISA, can not use a 40 year period to amortize benefit, method, or assumption changes, and have not been eligible to do so for any changes adopted after the effective date of ERISA. Recent changes (in 1987) have further shortened the periods over which private plans must amortize changes and experience losses.

When do contributions to the State pension funds stabilize? Under current law the contributions to the TPAF are scheduled to be stable or declining as a percent of pay after 2006. Under the proposal, contributions are scheduled to increase as a percent of pay until at least the year 2027. The long term outlay for the pension plan is the benefits paid less the investment income earned. Since the proposal will reduce the amount of assets in the trust compared to current law, long term outlays will stabilize at a higher level than under current law.

Is the State's proposed method more responsive to changes in the size of the State's workforce? This statement is not supported in the actuarial literature. Indeed, since, under the proposal, unexpected turnover would generate smaller gains and losses which would be amortized over a longer period, it is clearly not true for the portion of the contributions which spreads the cost of changes in accrued liability. To the extent unexpected turnover occurs primarily among participants with lower tenure, it is also untrue for the normal cost portion of the contribution, and therefore in combination.

Our review is based on:

- the calculations contained in the summary report sent by Buck Consultants to Mr. Brian Clymer on March 23, 1994,
- the undated chart prepared by Buck that NJEA had supplied us (attached to our April 11, 1994 letter),
- further backup to those numbers supplied directly to us by Mr. Robert Baus of Buck,
- information in Mr. Clymer's testimony to the Appropriations Committee
- additional graphs sent to us by Mr. Baus of Buck Consultants.

ACTUARIAL SCIENCES ASSOCIATES

ASA is an nationally recognized actuarial and employee benefits consulting firm. ASA's central office is located in Somerset, New Jersey.

ASA assisted in developing the December 1, 1989 State of New Jersey Pension Funding Policy which established guidelines for setting reasonable funding for New Jersey.

CHRISTOPHER M. BONE

Mr. Bone is Chief Actuary with Actuarial Sciences Associates. His work has focused on consulting involving the modeling, analysis and design of postretirement employee benefits (pensions, health and life insurance). He has also worked on proposed changes in the legislative and financial reporting areas.

He is active in both trade associations and professional organizations. In the past he has chaired the ERISA Industry Committee (ERIC) Task Force on Interest Rates under OBRA87 and the Coalition for Retirement Income Security (CRIS) Task Force on the Full Funding Limit. A frequent speaker, he has testified before the IRS, PBGC and Treasury staff. Currently he chairs the Society of Actuaries' Committee on Retirement Systems Research.

Mr. Bone, an Alumni Distinguished Scholar, graduated from the Honors College, Michigan State University with a BA in mathematics. He is a Fellow of the Society of Actuaries, an Enrolled Actuary under ERISA, and a Member of the American Academy of Actuaries.

John D. Marshall

Mr. Marshall is a Consulting Actuary with Actuarial Sciences Associates, Inc. (ASA). He has over 18 years experience in the employee benefits field. His range of expertise includes qualified retirement plan design both public and private, design of postretirement medical & life insurance plans, design and funding alternatives of nonqualified retirement arrangements, and compliance maintenance and testing under ERISA, IRS, FASB, and GASB.

Mr. Marshall has lectured at actuarial seminars on various topics including early retirement incentives for public plans, cash balance plans, nondiscrimination and coverage rules, asset/liability projections, creative uses of excess pension assets, and integration (permitted disparity) with Social Security. He is the chairman for the EA-2 Examination Committee overseeing one of the two examinations required for an actuary to practice before the IRS. He received a B.A. from Wheaton College (IL) and is a Fellow of the Society of Actuaries, a Fellow for the Conference of Consulting Actuaries, a member of the American Academy of Actuaries, and an Enrolled Actuary under ERISA.

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Coming Up Short Public Pension Plans Are So Underfunded That Trouble Is Likely Many States and Localities May Have to Cut Benefits Or Raise Taxes Sharply Some People Delay Retiring

By LESLIE SCISM

Staff Reporter of THE WALL STREET JOURNAL

Dale Barry dreamed of retiring at age 60 from his state job in Maine. He and his wife would flee the harsh winters, move to Arizona and "get as much out of retirement as we could before the real medical problems hit."

But well after his 60th birthday, Mr. Barry is still working, despite having had cancer surgery and a heart attack. That's because Maine lawmakers attacked the state's \$2.6 billion pension-account underfunding by postponing retirement for him and 21,000 other public employees.

Mr. Barry, who works as a veterans' counselor, has become a veteran himself in a new kind of war—between taxpayers who are sick of high taxes and public employees who claim to have given up a chance at higher pay in the private sector for the security of a government job.

A Surprisingly Big Problem

Although relatively few people are aware of the problem, state and local pension plans across the country are more than \$125 billion short of the money they will need to meet their pension promises. Counting in federal civilian and military employees, the underfunding—the gap between what has been salted away and what will be required—is \$1.24 trillion. That's 23 times the more widely publicized underfunding of private-sector plans that, like Maine's, pay fixed pensions.

"Public-pension underfunding will be the health-insurance crisis of the next century," predicts Dennis Spice, who heads an underfunded Illinois state plan.

To meet obligations to public employees, why not simply raise taxes? That's starting to happen. But as taxpayers discover the size of the pension-funding bill, they are beginning to rebel. "The T-word is used as a political club," says Dale McCormick, a Democratic state senator in Maine.

So, reluctant to hit up taxpayers for the full bill, many politicians are slashing benefits. But in some dilatory states, the

underfunding problem may worsen. A prime example is New Jersey, where Gov. Christine Todd Whitman is hoping to save about \$650 million through July 1995 by tinkering with retirement-plan funding.

A Town's Shortfall

In Coventry, R.I., Finance Director Barry Yeaw stares bleakly out an office window at pitted roads and worn-out dump trucks. The police pension fund has just \$840,000 set aside to meet \$12.2 million of pension obligations. The city of 32,000 raised real-estate taxes 3% this year and more than doubled its pension contribution to \$495,300. But its 36 retired officers are already drawing \$396,000 a year.

"We don't know how much more the taxpayer is going to take," Mr. Yeaw says, noting rising foreclosure sales of tax-delinquent real estate, more tax bills paid with bounced checks, fewer high-paying jobs. With the Pentagon budget squeezed, the submarine-building work force has shrunk at the nearby Electric Boat division of General Dynamics Corp.

So, Coventry is prodding its 50-member police force for pension givebacks. It hopes to scale back a provision that has allowed officers to work heavy overtime in their final year and get benefits based on the increased income. Mr. Yeaw wishes that his predecessors a decade ago had never made such concessions to avoid cash pay raises, but the officers contend that the problem is the town's own fault. "If they'd funded it properly over the years, it wouldn't have come up and bit them all at once," says Kurt Wallace, a 42-year-old detective with 10 years on the force. Adds Mark Currier, another veteran officer: "They want us to fix what they broke."

Acting Unilaterally

Although many towns are whittling down retirement benefits in labor negotiations, Maine's Republican Gov. John McKernan took a holder step: He proposed legislation that would unilaterally replace the old system with a less generous one. With the state mired in billion-dollar deficits, he said it couldn't afford to keep paying retirement benefits higher than those in the private sector. Maine's state teacher benefit averages \$16,000; other public employees get \$13,000.

State lawmakers, reluctant to offend all 41,000 employees involved, approved last summer cutbacks less sweeping than those Gov. McKernan proposed. They saved the harshest cuts for workers with less than 10 years' seniority; at the 10-year mark, workers become "vested," legally entitled to a current or future retirement benefit. Now, workers short of 10 years, such as Mr. Barry of Lewiston, have to stay two years longer on the job than more-senior colleagues for similar payouts. All employees now contribute more money toward pensions—7.65% of their pay, up from 6.5%.

"It was a choice between a completely evil, noxious solution and a merely evil solution," Sen. McCormick says.

The Maine State Employees Association sued, contending that benefits couldn't be changed unilaterally, and won in a state court. But Maine's supreme court disagreed, holding that the law creating retirement system carved out "general policy principles," not "immutable contractual rights." And the U.S. Supreme Court declined to hear a union-backed appeal.

All that doesn't comfort Lorraine Auger, a 57-year-old clerk-typist who missed being on the right side of Maine's 10-year cliff by months. "They reneged on us," she says, noting that a personnel manager interviewing her for the job, had touted the retirement package. Mrs. Auger says she might have earned more in the private sector, but "the state's whole benefits package had seemed so terrific. It really attracted me to the job."

Not long ago, she and her husband were planning to retire to Venice, Fla. "Now, it's totally different," she says. Since the politicians reduced the benefits once, she adds, "Who knows what's in the future?"

In the private sector, of course, many employers already are forcing retirees to foot more medical bills. And many companies have swapped fixed-payment plans such as Maine's in favor of ones in which the employer makes annual contributions and the employee assumes the investment risk.

In any pension-shuffling, many state and local employees get less protection than do many private employees because the Employee Retirement Income Security Act (the federal law known as Erisa) doesn't apply to public plans. A company canceling a plan must compensate workers for all earned-income benefits up to that point, perhaps by buying them annuities, says Bronislaw Grala, a retirement-law expert and lawyer at Cadwalader, Wickersham & Taft in New York. Erisa prohibits the sort of income-benefit erosion that Maine legislated for nonvested employees, Mr. Grala notes.

Minimum Funding Requirements

Erisa also protects private-sector employees by specifying minimum funding for pension plans. As a result, just 5% of all private plans have less than 75% of the assets needed to meet liabilities, says Olivia Mitchell, executive director of the Pension Research Council at the University of Pennsylvania's Wharton School. In contrast, nearly 30% of public plans are less than 75% funded, she estimates.

At the Washington, D.C., Fraternal Order of Police headquarters, Vice Chairman Ronald Robertson lambastes the notion that he should help local politicians solve a \$4.9 billion unfunded-liability problem. "By golly, when you risk your life for 20 years, it's not too much to ask that people take care of you in your old age, as promised," the 55-year-old detective says.



**New Jersey
Principals and Supervisors Association**

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**NJPSA Position Statement
Governor Whitman's Pension Proposals
May 19, 1994**

The New Jersey Principals and Supervisors Association, representing over 5,000 active and retired public school principals, vice-principals and supervisors, is deeply concerned about Governor Whitman's proposals concerning our pension and health benefits. Based upon the review of these proposals by our pension consultants, we believe that the Governor's proposals threaten the future security of our pension and health benefits systems.

However, we believe that this Committee and the Legislature, if given full and accurate information about the nature and impact of these policy proposals, will seek an alternate approach. We are concerned however, that the existing time constraints of the budget process may cause the Legislature to act on these proposals without all the necessary fiscal and actuarial data needed to decide this critical issue. The actuary of the Teacher's Pension and Annuity Fund has already acknowledged a serious mistake in the calculation of savings accrued under the new plan. We urge you to demand a full actuarial study before making a decision which affects the security of future funding of pensions and health benefits for hundreds of thousands of school and public employees. We also urge you to meet with the leadership of all affected employee groups to discuss alternatives.

With respect to the specific proposals presented by the Governor, our association strongly opposes the elimination of the prefunding of post-retirement medical benefits, the deceleration of the prefunding of the COLA for current and future retirees, the unit credit funding proposal and the unilateral elimination of the 2% social security offset.

1. We believe that funding post-retirement medical costs on a pay-as-you-go basis threatens the fiscal stability of the plan, and ignores existing law. It is our understanding that the current reserves in the SHBP will be used up within a mere three years. What happens to those benefits then?
2. We also oppose the deceleration of the COLA payment schedule because this proposal subjects future retirees' cost of living adjustments to the vagaries of the economy and the annual appropriations process. We are relying on the Legislature to honor its commitment to prefund the COLA which was made to public employees during the recent revaluation.
3. Although the unit credit funding method may be used in other states, the vast majority of states utilize the entry age method of funding their public pension systems due to its reliability and stability over time. It also is fair to current and future taxpayers. Current taxpayers, who effectively contribute to public employee pensions, are getting a direct return on their investment, i.e. the services of the public employees. The proposed unit credit method, will break that relationship by permitting the state to make a smaller contribution to the overall liability of the system each year. Instead, future taxpayers,

who may receive no services from the individual retirees, will have to foot the bill for these pensions. Not only is this poor economic policy, it is poor public tax and pension policy. Our experts tell us that this method is likely to cost the state more in the long-run for employee pensions. **Why are we tampering with a system that is recognized as one of the most healthy, stable and reliable, in the country?**

In short, we ask you to seriously consider each of the Governor's pension proposals and to work collaboratively with the impacted employee groups to find a mutually agreeable resolution of this critical issue. Thank you for considering the views of the New Jersey Principals and Supervisors Association.

Submitted by: Debra J. Cosgrove

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