State
of the
State Pension Systems

August 24, 2006

Agenda

- Introduction/Overview
  - Actuarial Methodology
  - Budget Implications
- History
- Current Status
- Questions

What is the Purpose of a Retirement Benefit?

- To attract and retain a qualified and capable workforce

- To ensure an adequate “replacement” income to career employees

The Nature of a Defined Benefit Plan

- Employer guarantees a specific monthly amount at retirement
- Employer makes contributions
- Employee required to make contributions
- Employee does not make investment decisions
- Employer and employee contributions grow over time
- Oversight of Plan assets and liabilities

Risks?

- Benefits guaranteed
- Benefits erode without protection from inflation
- Benefits not portable
- Asset growth not guaranteed
  - Requires steady contributions
  - Miracle of compound interest
  - Investment Risk
- If assets cannot match promised benefits, pension payments have to be covered out of operating income through the budget

Tracking Assets & Liabilities Key to:

- Control Risk
- Proportion “Funded”
- Budget Stability

Experience Determines "Key Drivers for Funding"

- Life Expectancy
- Size of Workforce
- Career Service
- Salary Growth
- Inflation

“Key Drivers for Funding”

- Gains and losses are recognized over rolling 5 years to limit volatility
- Actuarial value of assets versus actuarial liabilities determines

  funding status

  need for employer contributions

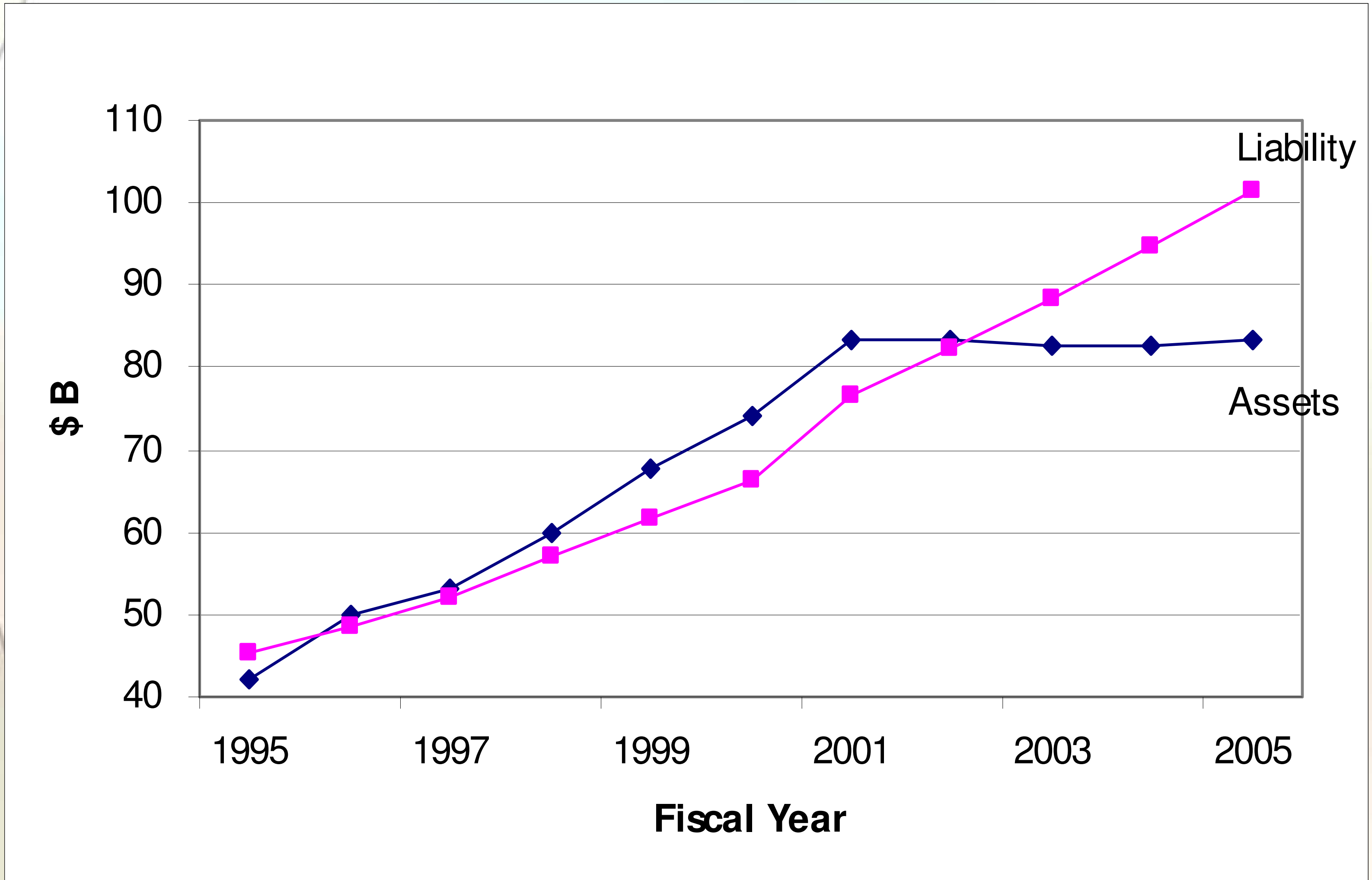
Funding Requirements are Dynamic and Change over Time

- Normal Cost – present value of service earned for that year
- Accrued liability – present value of all past service
- If liabilities exceed assets, we have an unfunded accrued liability which is amortized over a number of years

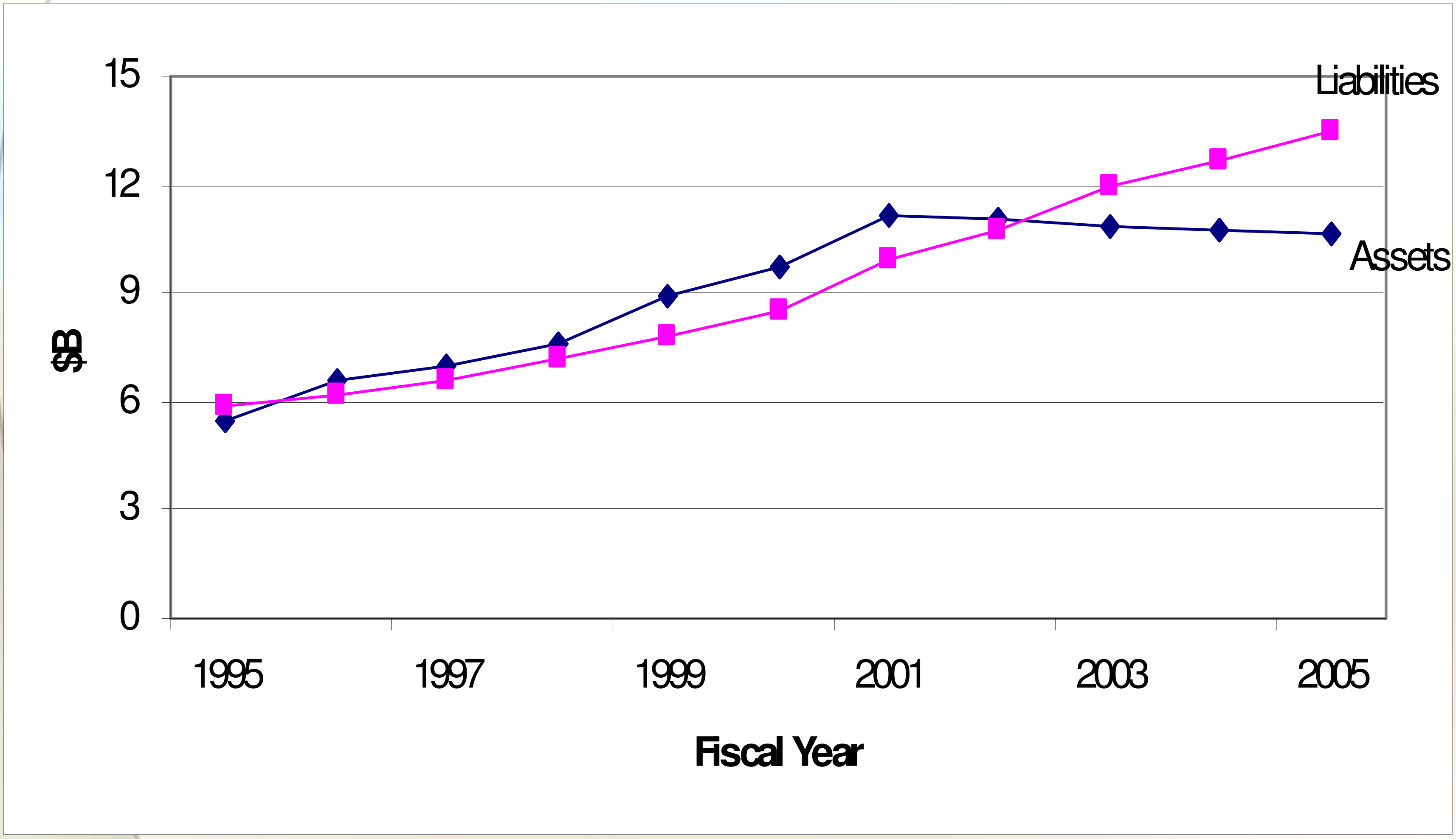
What Is The Challenge?

- Growth in cost of pension and other employee benefit programs
- Finding adequate funding to meet ever growing demand among competing interests

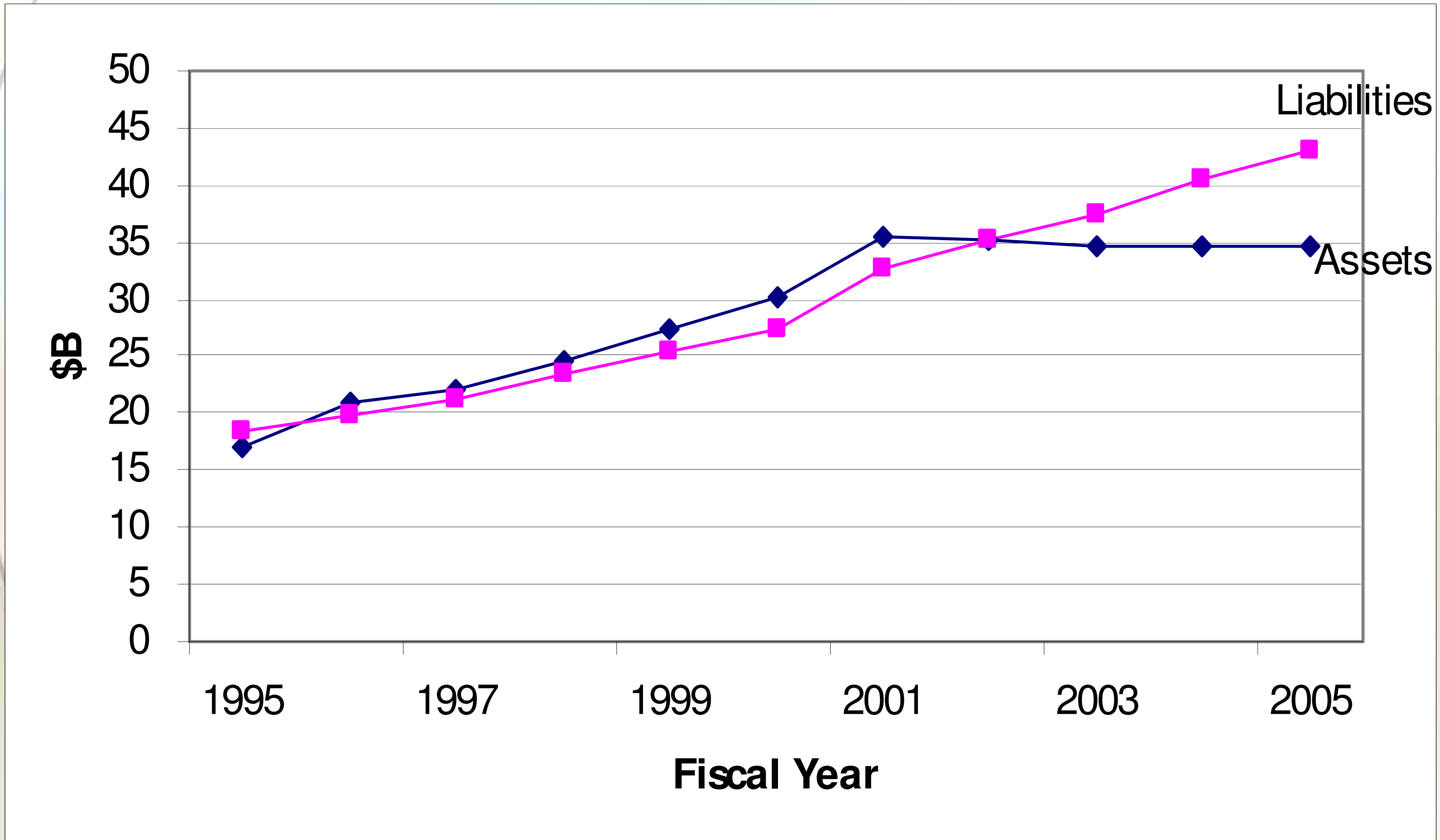
Asset/Liability Comparison All Systems
Funded Ratio: 82.3%



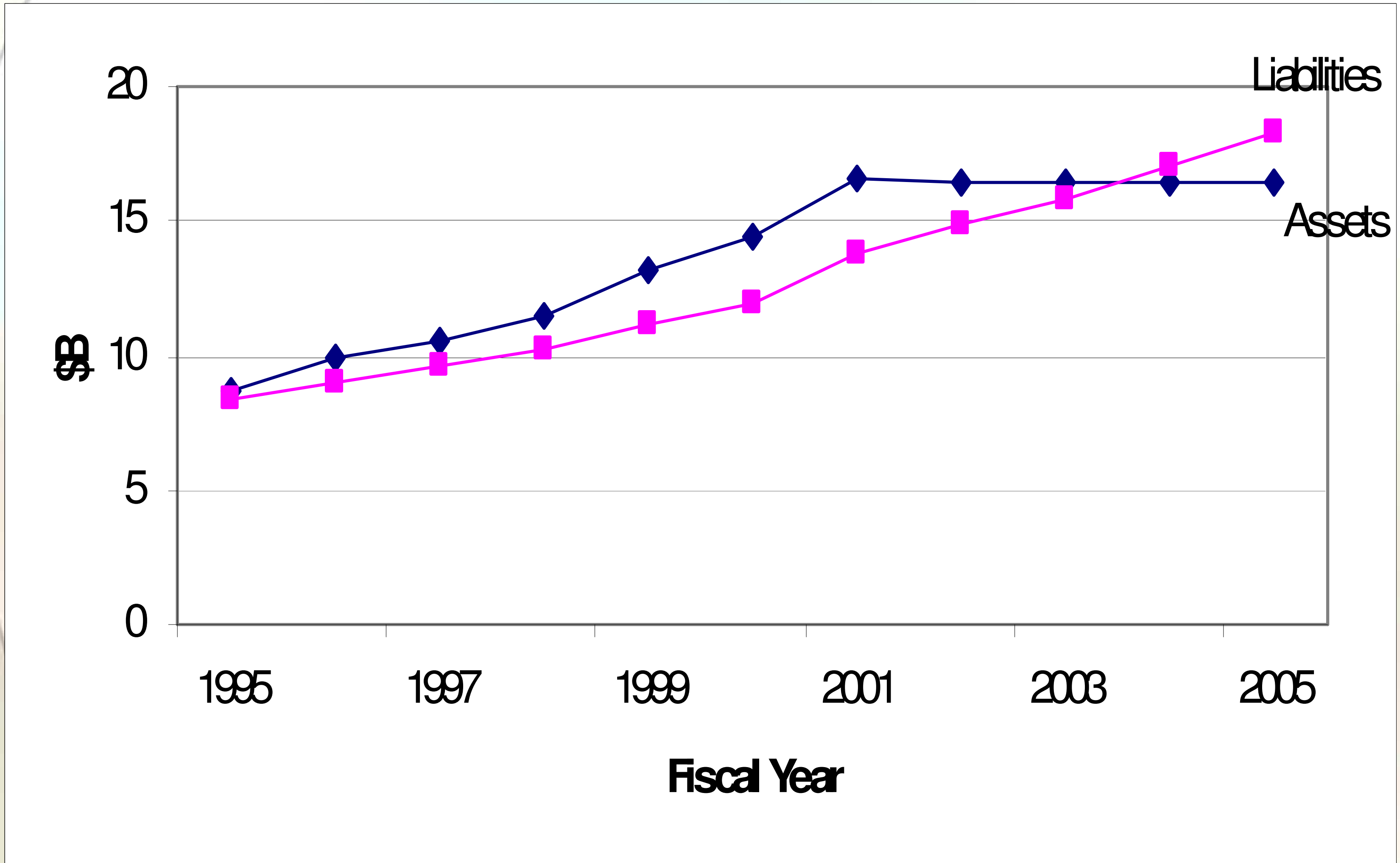
Asset/Liability Comparison PERS State
Funded Ratio: 79.1%



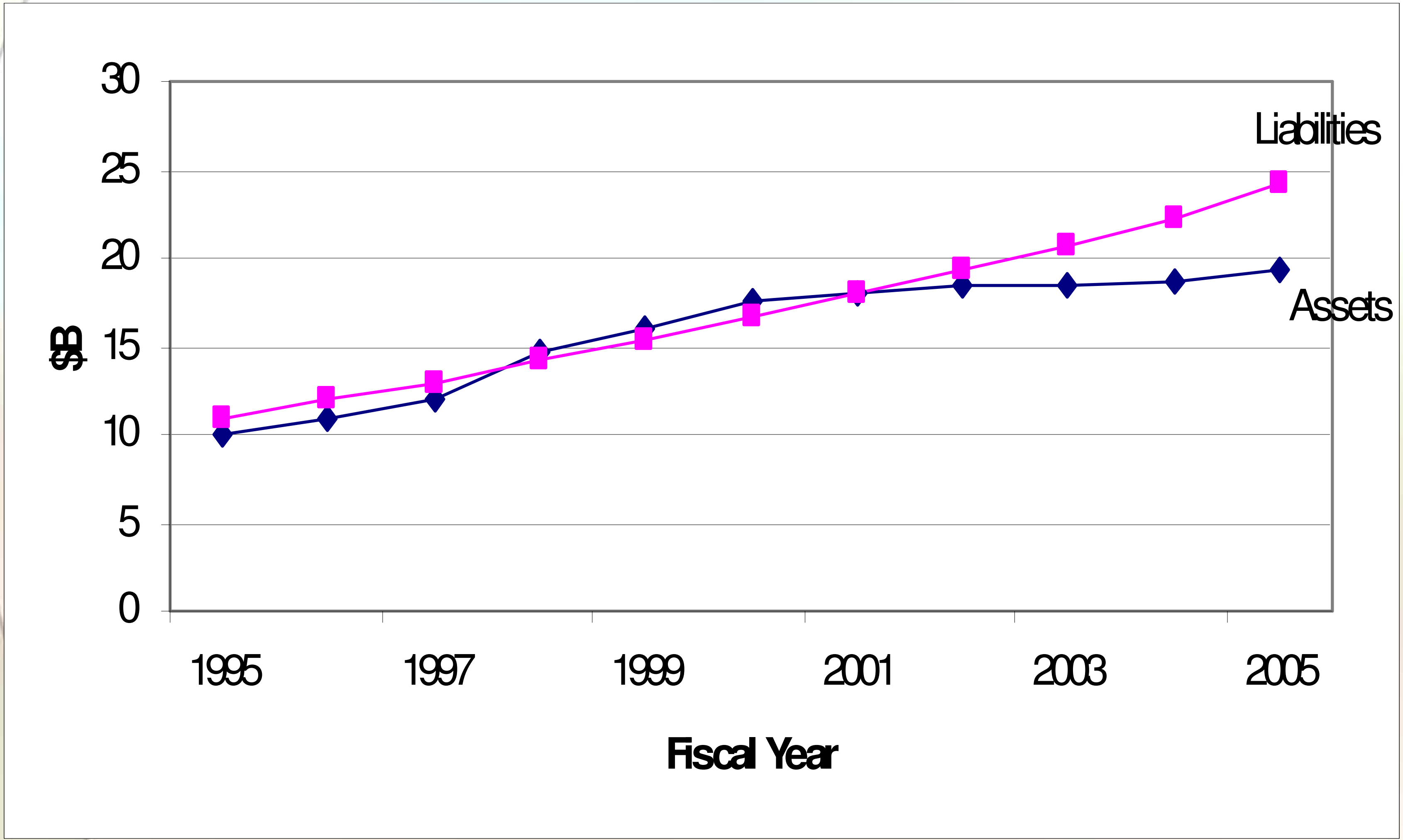
Asset/Liability Comparison TPAF
Funded Ratio: 80.3%



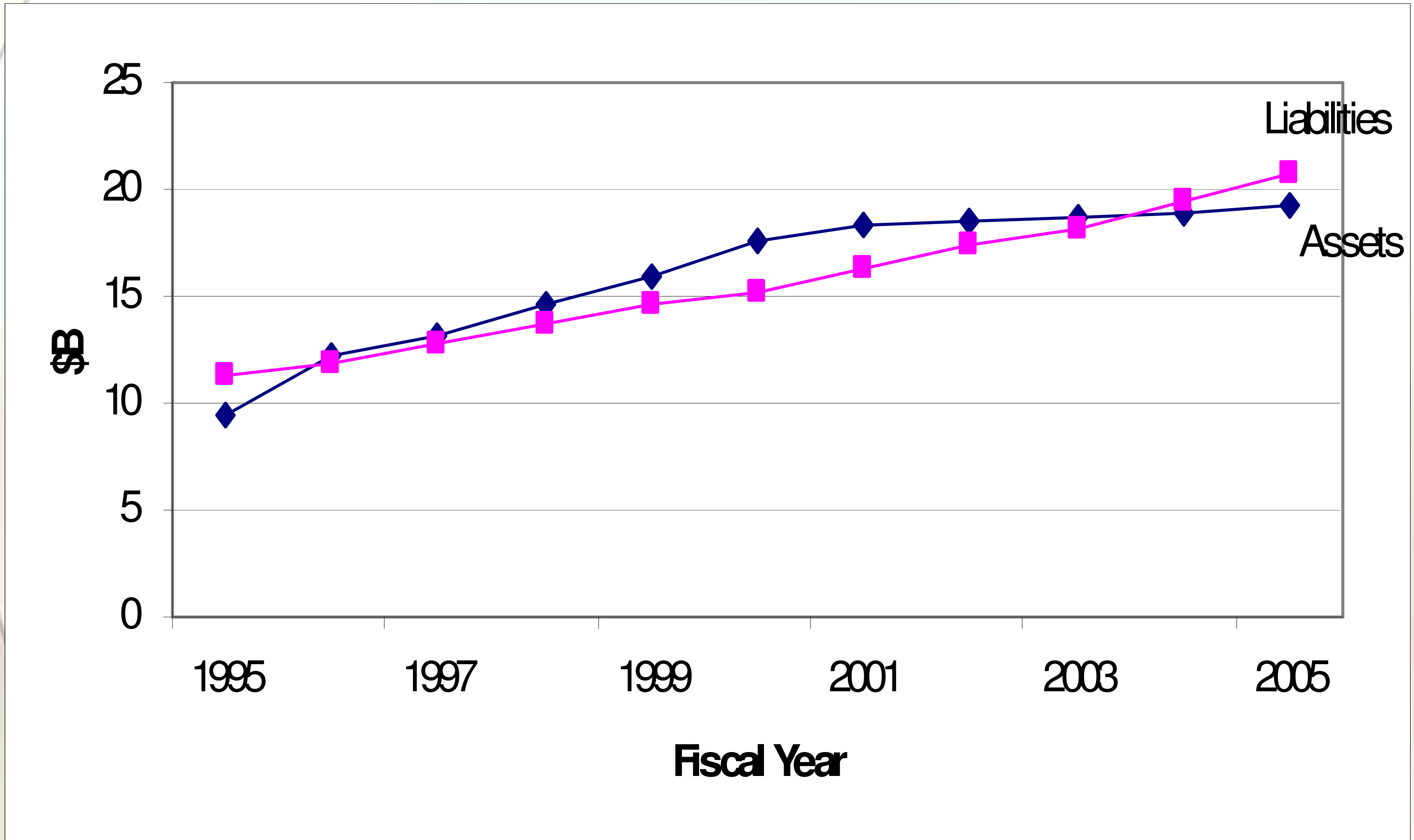
Asset/Liability Comparison PERS Local Funded Ratio: 89.9%



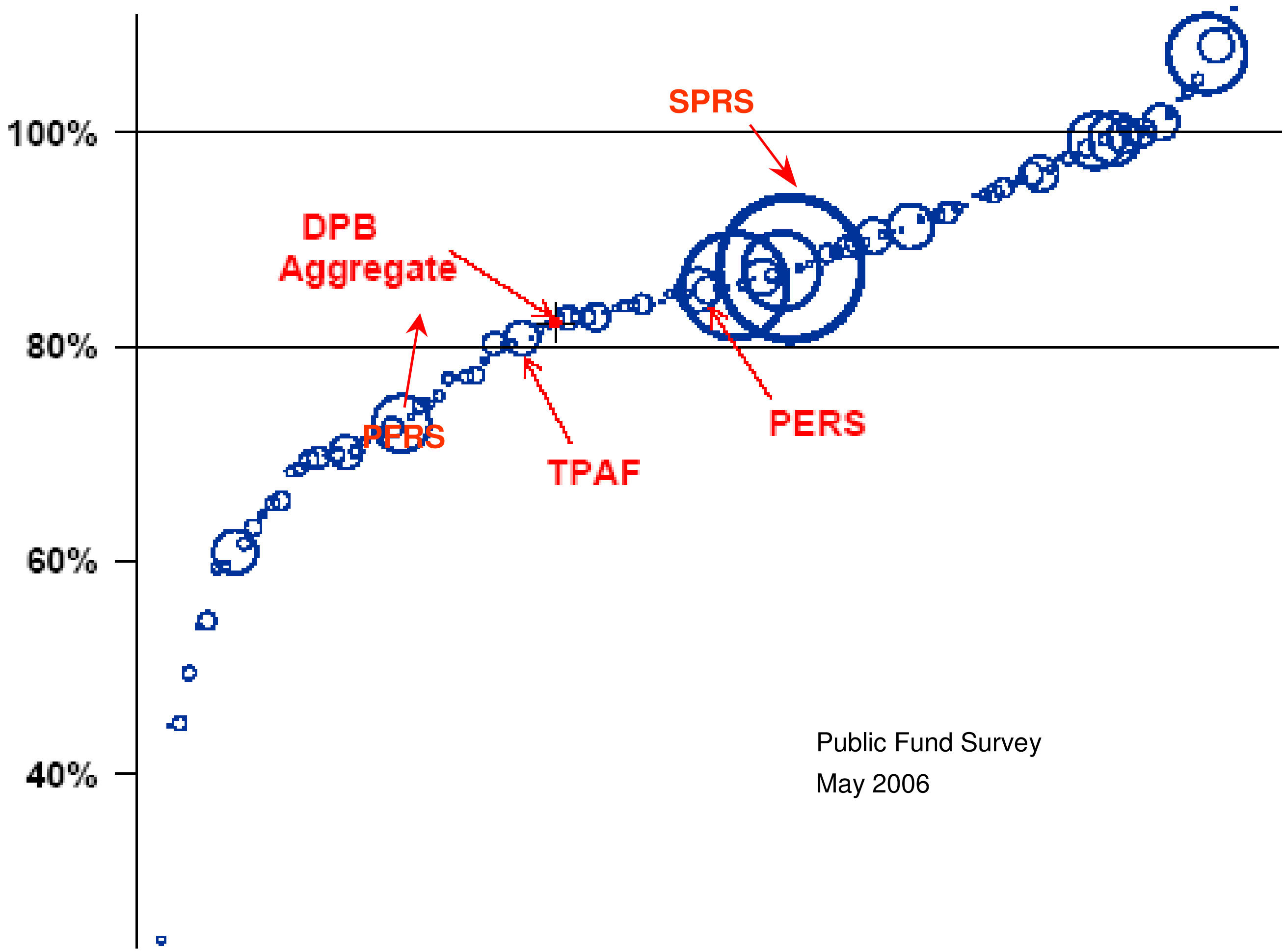
Asset/Liability Comparison PFRS Funded Ratio: 80.1%



Asset/Liability Comparison SPRS
Funded Ratio: 92.6%



Are We Alone?


100%
80%
60%
40%
SPRS
DPB
Aggregate
PFRS
TPAF
PERS
Public Fund Survey
May 2006

Brief History

- Issuance of Pension Obligation Bonds-$2.8 billion
- Authorized temporary change in actuarial method (Mark to Market)
- Authorized use of surplus assets to offset employer contributions-State and local employers get pension holiday
- Reduced employee contributions for PERS and TPAF
- Backloaded Debt Service

"How Did We Get Here?"

- Surpluses grow-
  - positive returns of late 90s
  - bond proceeds
  - Mark to Market
- Investment returns go south beginning in FY2001
- Benefits enhanced for PERS & TPAF (FY 2002), & PFRS (FY 2000) adding over $5 billion in liabilities to the systems
  - Another Mark to Market (retroactive to 1999)
- Limited or no employer contributions for seven years
- By FY 2004 pension contribution holiday comes to an end
  - Budget problems make contributions difficult
  - All benefit costs affect budget - Pension and Health
- Phase-in adopted in FY 2004

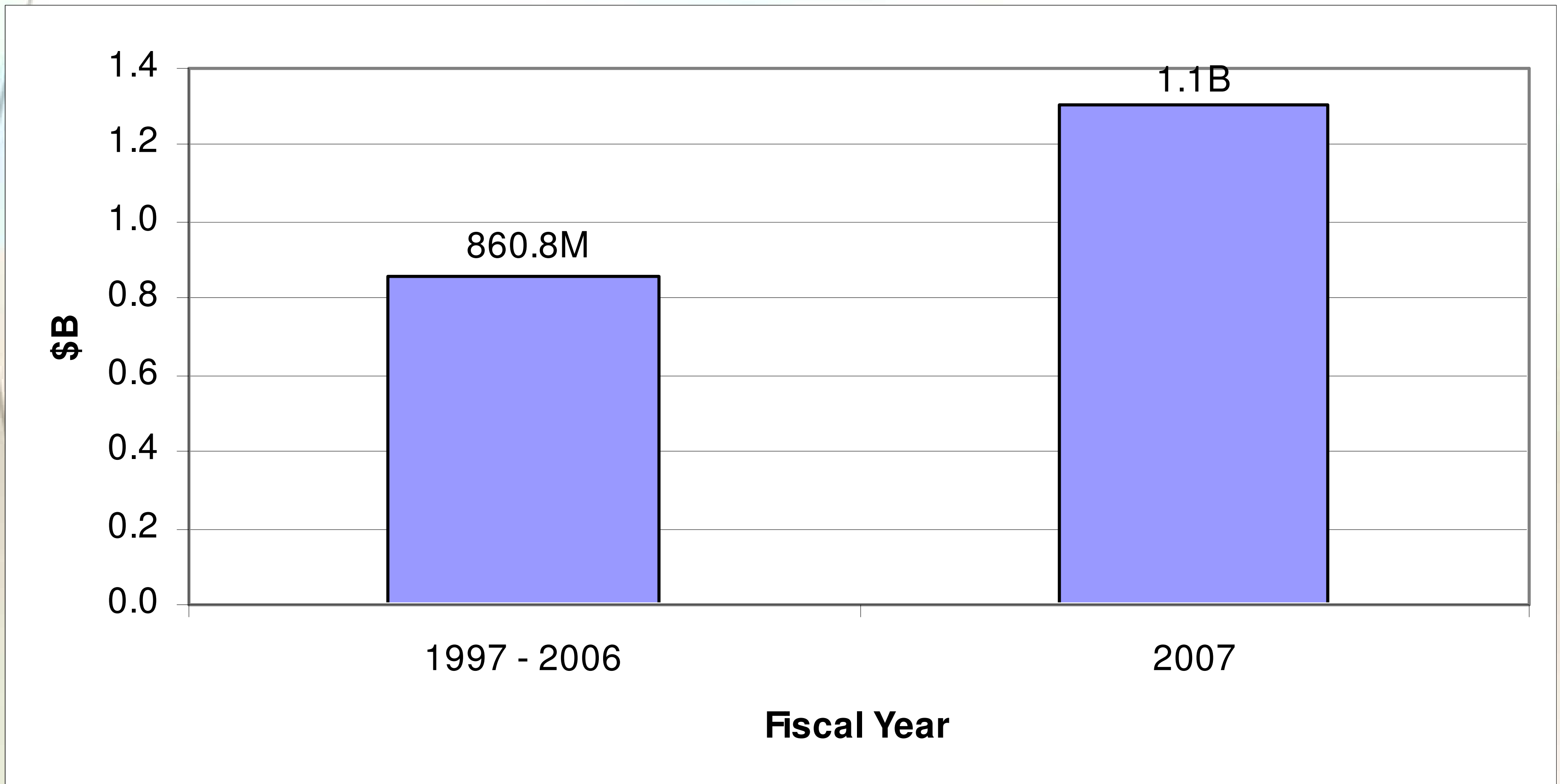
New Jersey's Liabilities are Growing Faster than our Assets

- Limited/No Employer Contributions
- Benefit Enhancements
- Benefit Payouts: $5B/yr. and growing
- Retirees living/collecting benefits longer
- Actives with higher salaries & more service credit

What Needs To Be Done?

- Make/Increase the employer pension contribution
- Work to improve investment performance
- Better match growth in assets and liabilities

Current Budget Appropriates Pension Contribution of $1.1B



Benefits Review Task Force Recommendations

Areas of Concern

- Those recommendations that have a financial impact on the benefit systems
- Those recommendations that address the integrity of the systems

System Integrity

- Make full, actuarially sound pension payments
  - Over $8 billion dollars in actuarially required contributions have been avoided
- Practice good fiscal stewardship and do not use unsound techniques
  - Do not alter actuarial assumptions to meet budgetary constraints or to finance other initiatives

System Integrity

- End boosting, padding and tacking
  - No pension for contractors/vendors
  - No DB Participation for elected or appointed officials
  - No tacking of several jobs
  - Restrict end of career salary hikes
  - End sick day manipulation

System Integrity

- Any proposed legislation must include the following elements for PHBRC consideration:
  - A fiscal note in the body of the bill
  - Description of revenue sources to cover costs
  - Certification that costs and revenue projections are based on generally accepted actuarial principles

Actionable Short-Term Issues

- End Pension Loans or Charge Market Rate Interest
  - Current outstanding balance exceeds $1.1B
    - At 4% interest and with State assuming an 8.25% rate of return, lost earnings potential exceeds $45M per year
- For “pension purchase”, determine a way to factor in the cost of health insurance
  - Current purchase cost address pension benefits only

Short-Term Gains

- Declare a moratorium on ERIs
- Declare a Moratorium on Benefit Plan Improvements

Longer-Term Solutions

- Adhere to “n/55” Retirement Calculation
- Anti “two tier” philosophy
  - The Committee should look at available alternatives; actuary will present additional information next week
- Provide for Part-Timers
  - Encourage this Committee to consider the originally stated intent of a retirement plan

Longer-Term Solutions

- Whether under the current system or a new design, early retirement age must be moved from 55 to 60
  - Estimated savings are very long term due to legal constraints
  - Types of Retirements
    - Early
    - Service
    - Disability

Longer-Term Solutions

- No pension credits for jobs paying less than $5,000
  - Use of a recognized benchmark, such as 1000 hours, or limits based on “full-time” status may be more appropriate as mentioned in Governor’s Budget Message
  - Those who do not meet the threshold could be covered under an alternative design such as a deferred compensation plan

Other Recommendations

- Standardize Life Insurance Fees and Benefits
  - Basic benefit – Employer Paid
    - PERS = 1.5x Base Salary
    - TPAF = 2.0x Base Salary
    - PFRS = 3.5x Salary
  - Entire group life system needs overhaul
    - Break linkage to pensions
    - Standardize employer paid benefit
    - Allow for employees to buy varying levels of optional coverage

Other Recommendations

- Amend dual pension and salary
  - Too many cases of retirement and reemployment
  - Inconsistencies in application (statute) across systems
  - Complicated to administer and manage
  - Difficult for participants to understand

Other Recommendations

- Revise Pension “pop Up” Increases
  - Upon death of a beneficiary, participants can revert to their full unreduced benefit
  - Limit the “pop up” to a period of up to 5 years from retirement
- COLA
  - Eliminate COLA for those who vested in State system but who are not actively working at the time of retirement

Other Recommendations

- Change disability pensions to a disability insurance system
  - No middle ground today between retirement and disability
  - Guarantees salary replacement while disabled but allows time to determine if an employee can be returned to employment
  - Estimated Annual Savings
    - State $28.2M
    - Local $53.5M

General Comment

- Pension laws and regulations are too complex; costly to administer and difficult for the members to understand
- Major overhaul should be a goal to:
  - Reduce administrative expenses
  - Eliminate disparities between systems
  - Help participants better understand and appreciate their benefits