
Public Hearing

before

SENATE STATE MANAGEMENT, INVESTMENT AND FINANCIAL INSTITUTIONS COMMITTEE

“The State’s public pension systems, investments,
and related policies and legislation”

LOCATION: Committee Room 1
State House Annex
Trenton, New Jersey

DATE: May 20, 1996
1:00 p.m.

MEMBERS OF COMMITTEE PRESENT:

Senator Peter A. Inverso, Chairman
Senator William E. Schluter, Vice-Chairman

ALSO PRESENT:

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



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SENATOR PETER A. INVERSO (Chairman): I am going to call the Committee hearing to order.

First of all, I certainly want to express my thanks to the Treasurer for agreeing to work with me in conducting this hearing, to have available all of his professionals and people who have the expertise in this area.

The reason I asked to have this hearing was, first of all, I think pension oversight is part of the responsibility of this Committee. I think it is appropriate in view of a lot of the information, maybe misinformation that has been circulating about where our pension plans stand, vis-a-vis the Pension Reform Act of about two years ago. Pensions is a very complex area, an area, of course, that has everyone's interest, particularly those who are participants and expect to be beneficiaries -- retirees of the system. So it is important to get an overview of where we are today in view of where we thought we would be.

This is not meant to revisit whether or not the Reform Act was appropriate. It was passed by the Legislature. We deemed it appropriate at the time. My interest is the performance of the plans as measured by typical benchmarks, what was expected, what was anticipated, and how we are faring in that regard. That is where we intend to have this hearing go.

We will have presentations by the Treasurer and others in the administration, and then we have some other individuals who wish to speak: Jim Schroeder, Peter Christensen, John Loos, and Ray Kalainikas. They will have an opportunity to make their presentations, and then we will have a question and answer session that will follow.

I would ask that all questions come through the Chair. We will handle it in that manner.

With that, I will ask the Treasurer to open it up with his comments.

STATE TREASURER BRIAN W. CLYMER: Thank you very much, Mr. Chairman.

First of all, I would like to state my personal appreciation for the efforts you put into this and many other issues of the budget, not only of this year, but in past years as well. We appreciate the collegial way in which you approach issues and the public way in which you do it as well. Anyway, thank you, and Senator Schluter as well, for joining me today.

Joining me today, not immediately at the podium, are: Bob Baus, the State's actuarial consultant; Marge McMahon, on my left, the Director of the Division of Pensions & Benefits; Tom Bryan -- in the audience as well -- from the Division of Pensions; and to my immediate right, Roland Machold, Director of the Division of Investment.

I want to thank you for the opportunity to discuss the financial strength of the State's public employees' retirement systems.

At the close of the last fiscal year, the State pension systems had amassed \$41 billion in assets. That sum represents more funds than are needed to satisfy every current liability of the systems. In fact, our pension systems are supported by a level of assets that are among the highest in the nation.

According to the most recent annual survey of pension funds performed by "Pensions and Investments" magazine, New Jersey's retirement systems ranked 11th among all pension funds, public and private, in terms of

assets. Among public pension funds, New Jersey ranked 8th. The State pension fund is financially sound and secure.

In the last fiscal year, benefits which were paid out of the funds totaled \$2.3 billion, while the State still added \$2.9 billion in additional assets. Today, the assets of the pension systems have grown substantially, totaling \$44 billion.

For the sake of comparison, our pension assets are almost three times as much as the entire \$16 billion State budget proposed for Fiscal Year 1997.

When I took office as State Treasurer in 1994, my mission was to get State spending under control. One of the major cost drivers in the budget was the State contribution to the Public Employee and Teacher Pension Funds. Taxpayers were scheduled to contribute \$602 million in the budget proposed by the previous administration. This represented approximately 4 percent of the proposed \$15.6 billion budget. It was estimated that the taxpayer contribution would grow to \$1.3 billion by Fiscal Year 1998.

Because of the pension reform legislation, we were able to significantly reduce the State's pension contribution and still provide secure and adequate funding for all of New Jersey's public employee retirement systems.

There were \$37 billion in pension assets when I was named State Treasurer. This has grown to \$44 billion -- \$7 billion in additional assets in just two years following the successful implementation of pension reform.

Public employee and teacher unions opposed pension reform, and are now suing me personally in Federal court in an attempt to overturn the

reform. Their argument is that we are underfunding the retirement systems and, in the near future, contributions will rise dramatically. This, they claim, will result in voter and taxpayer outcry for a reduction in pension benefits.

The passbook for the pension bank account clearly indicates how unfounded this concern is. The account balance has increased by 19 percent in the two years since pension reform.

With respect to their concern over contribution levels, we were at the threshold for public outcry in 1994. It would have become a roar by 1998 if we had left the taxpayers to pick up the bill for the increase in the State's projected contribution level of more than \$1 billion, as it would have without reform.

When we looked at the funding requirements under the prior law, it seemed clear to us that we were heading toward an overfunding of the retirement systems within a short time period. This was totally unnecessary and an unwarranted burden on current taxpayers. The same level of benefits could be maintained with substantially reduced contribution levels. This is possible because of the nature of public employers.

Our critics did get one thing right when they stated that government is different from the private sector. There is little danger of a government going out of business. It is, therefore, not necessary to overfund the public retirement systems to protect against that possibility. However, there is a real danger to New Jersey's taxpayers from overfunding the State retirement systems.

Employment in the public sector, and the accompanying salary and fringe benefits, are not subject to the forces of the marketplace, as they are

with private employment. The high level of benefits for teachers and public employees was obtained primarily through the political process.

There are numerous proposals for enhancement of public employee benefits each legislative term. One of the arguments usually advanced in support of these measures is that there is plenty of money in the retirement systems to pay for the enhancements. So, rather than the train wreck that the unions predicted for our future, the more likely danger that faced the State was a runaway train of employee benefit enhancements which would have trampled the pocketbooks of the State's taxpayers unless we got it under control.

Through pension reform, we were able to apply the brakes and eliminate the easy argument that the systems can afford it. However, the taxpayers cannot.

Finally, when I think of the State retirement systems and their substantial funding levels, I am reminded of the words of a famous astronomer who frequently describes our universe as "billions and billions" of stars, planets, and other objects. In the firmament of New Jersey's public employee benefits, there are "billions and billions" of dollars to guarantee the security and longevity of that universe. And let us not overlook the fact that we cannot forget that billions of dollars more flow into the systems each year.

I am not suggesting that the funding of the State retirement systems is as secure as the universe itself, but in this State, on this tiny planet, in a small solar system on the edge of the Milky Way galaxy, it is about as good as it gets.

Mr. Chairman, with your consent, before opening the floor to questions, I would like to ask Mr. Roland Machold to update the Committee on the current status of the pension fund investments.

SENATOR INVERSO: I'm glad the audience was strong on astrology. (laughter)

ROLAND M. MACHOLD: Maybe we can use a little help.

First of all, I am very happy to be here as well, and to be with you.

I think the point of my comments today is to really try to reassure the Committee members and the public that the returns of the pension funds have been sound over time. One of the great concerns that is often expressed to me is whether or not we can make the 8.75 percent return that has been projected by the actuaries over time. I can never tell what the future is going to be, but I can tell you what the past has been, which is that for the last 10 years, our returns were a little over 12 percent -- 12.4 percent -- and for the last 5 years, about 10.7 percent.

In Fiscal Year 1995, the returns were 19.7 percent, and in Calendar Year 1995 -- which overlaps somewhat, of course -- they were 28.8 percent.

Now, obviously, there are good years and bad years in the marketplace. After the 28.8 percent, the year before that we had a break-even year. So it is difficult to say where we are going to go in the future. This fiscal year to date, the returns are about 8 percent right now, which is pretty much in line with what has happened in the markets, which are cooling off a bit. I cannot predict what is going to happen in the future, but I feel the past has shown that returns have been realized in the marketplace.

I have here a copy of our Annual Report, if anybody wishes to have one, and a little three-page sheet which gives some facts in case you want to ask any questions.

We measure our returns against the returns of other state pension funds. We have consistently been in the top 20 percent of all state pension funds in recent years, going back to 1981.

I will stop with that.

SENATOR INVERSO: Again, Roland, we are very pleased to have you at the helm of the Division of Investment. You do a great job year in and year out, except for that little apparition, which really was part of the current actuary report, and includes the one down year you had.

MR. MACHOLD: It also does not include the one up year.

SENATOR INVERSO: Right, right. But the year subsequent to that was the year that you hit 20 percent.

You mentioned 8 percent so far this year. Is the likelihood of maintaining that good, or do you think there might be a greater strain on that 8 percent?

MR. MACHOLD: It is very hard to say.

SENATOR INVERSO: Are you talking fiscal--

MR. MACHOLD: Fiscal year, yes. Actually, our returns in this quarter are a little better than that.

It is impossible to say within a-- We only have a few more weeks before the end of the fiscal year, and anything can happen in the marketplace. We are very broadly diversified, so what happens in one marketplace is often offset by what happens in another.

SENATOR INVERSO: I guess one thing you keep in mind when dealing with this issue, as well as other issues involved in the pension system, is that a year does not make or break the assumptions and the variables in the system; that you have to look at it on a long-term trending basis. So we had that one down year, but it had no impact at all on your historic results.

MR. MACHOLD: Well, remember that any one year also is averaged in over time. So in terms of calculating the assets, the sharp increase or decrease in any one year will tend to be averaged out. That is why I gave you the longer term number, the 12.4 for the last 10 years.

SENATOR INVERSO: So for the last 10 years you have been well above the $8 \frac{3}{4}$ that you projected in the system. Okay. Thank you.

TREASURER CLYMER: I am going to ask Bob Baus to join us now as well, and we would be pleased to answer any of your questions.

SENATOR INVERSO: Before Roland leaves, one thing: Roland, we did agree that at some point in the future we were going to sit down with our Committee and go over the entire Division of Pensions in terms of the philosophy and where you are going. Derivatives have not made the newspapers lately, but we want to make sure that we are not vulnerable, as some of the other states have been, with regard to some of those aggressive derivatives. We still have that on our agenda to do with you.

MR. MACHOLD: I would be very happy to do that at any time.

SENATOR INVERSO: I know we spoke about that several months ago, and we need to do that. Maybe after this budget season is over.

TREASURER CLYMER: Just for the record, since we mentioned it here publicly, we do not do derivatives, so we don't have any (laughter) susceptibility to that segment of the market at all.

SENATOR INVERSO: Okay.

Yes, Senator Schluter?

SENATOR SCHLUTER: Thank you, Mr. Chairman.

I have to apologize first. I am new on this Committee so I am not up to speed as Chairman Inverso and others are, so my questions might be a little rudimentary.

SENATOR INVERSO: Excuse me. I think we might want to have Bob Baus, who is the actuary, make his presentation first, and then open it up for questions.

SENATOR SCHLUTER: Oh, okay. I'm sorry.

TREASURER CLYMER: We don't have a presentation. We just--

SENATOR INVERSO: Oh, you don't have a presentation. I saw the charts and I thought you had a--

TREASURER CLYMER: No, they are just for part of the conversation.

SENATOR INVERSO: Okay. So there is no one else from the administration of Treasury going to make any comments at this point in time. Okay.

All right, then, Senator Schluter, you may ask your questions.

SENATOR SCHLUTER: Thank you.

On the first page of your testimony you say that the total funds paid out in the last fiscal year were \$2.3 billion, and the total added was \$2.9

billion. I presume the lion's share of the \$2.9 billion is in appreciation of the investment portfolio. Is that correct?

ROBERT D. BAUS: Yes.

SENATOR SCHLUTER: Do you have figures which show, in a very simple way, the percentage of increase, the amount of increase, versus the premiums paid in? Or, could you get us that information?

MARGARET M. McMAHON: Senator, are you talking about a breakdown of contributions, employee/employer earnings?

MR. BAUS: And investment.

MS. McMAHON: And investment. There are three pieces to it.

SENATOR SCHLUTER: I would presume that the lion's share of this income is from the investments and the investment appreciation, capital gains. I see Tom Bryan shaking his head no.

THOMAS P. BRYAN: (speaking from audience) You have employer/employee contributions, which are substantial.

SENATOR SCHLUTER: Yes, but--

MR. BRYAN: I would say it is about 50-- Probably half of it is investment.

MR. BAUS: Are you talking about return or income?

MR. BRYAN: Income and return both.

SENATOR INVERSO: Tom, you need to speak into a microphone so it can be recorded. They are having trouble picking you up from back there. Could you just respond by coming forward?

SENATOR SCHLUTER: But you can, Ms. McMahon, give us this breakdown?

MS. McMAHON: Yes.

TREASURER CLYMER: We can provide that breakdown.

MS. McMAHON: Yes.

SENATOR SCHLUTER: Just generally, Mr. Treasurer or Mr. Machold, could you reassure me that the appreciation and the investment income are going to stay at the present high levels to keep this record in the trend it is going in right now? Is that prudent fiscal policy -- a prudent investment policy?

TREASURER CLYMER: I think it was prudent in the past. I have asked Roland in the past if he could give me those assurances. He has indicated that if he were able to assure those high levels of performance, he would be sending out newsletters from an office in New York and making a lot more money than he is right now. Nobody has that crystal ball, of course, as to what is going to happen in the market. Based on what our past performance has been, we can only--

While we have looked at 8 3/4 percent return, the performance over the last decade has been in excess of 12 percent. The percent in the last 5 years has been in excess of 10 percent. As you have seen from recent earnings, our last fiscal year was in excess of 19 percent, and for the last calendar year -- the calendar year just finished -- it was in excess of 28 percent.

Clearly, all those help to buffer returns in the future, because your base is expanded. You put 28 percent return of investments into the bank, and your funds grow by \$7 billion within two years. All those are earning at a rate of return even if they aren't at the 8 percent, because you put so much of a base into your funds, it all goes to protect the assets. We have clearly seen

that we have been able to sustain that rate. We think it is conservative, based on the investments of the fund. We don't have to take out of current earnings or out of investments in order to pay benefits. The benefits are paid out of current contributions. Therefore, the assets do not get moved around a lot, and the fund is able, for some small percentage, to take longer term positions and take positions and equities that allow them to get the higher rates of return. That is one of the reasons they have been very successful.

SENATOR SCHLUTER: Another line of questioning, if I may, through you, Mr. Chairman?

SENATOR INVERSO: Yes, go right ahead.

SENATOR SCHLUTER: Thank you.

On the third page of your testimony -- and I will repeat it -- you say: "There are numerous proposals for enhancement of public employee benefits each legislative term. One of the arguments usually advanced in support of these measures is that there is plenty of money in the retirement systems to pay for the enhancements."

Now, I would presume from the pension reforms or adjustments that we have enacted in the past couple of years that the employee contributions have gone down in total amount and total percent. Is that an accurate assumption?

TREASURER CLYMER: No. I would think they would have gone up. The employee contributions remain static, or are now fixed at 5 percent.

SENATOR SCHLUTER: How about the employer?

TREASURER CLYMER: The employer contributions have gone down as a result of pension reform, but they went down temporarily and then are expected to rise again.

SENATOR SCHLUTER: The total contributions -- employer and employee -- is at a lower rate, is it not, because of this--

TREASURER CLYMER: That is correct.

SENATOR SCHLUTER: Okay. Now, is the implication here -- and I hope you can follow me -- from what I read first, that with all of this money, politically, legislatively, it might be easier to use the excess for benefits other than pension benefits?

TREASURER CLYMER: Well, certainly that has been the case in the past where there have been excess benefits, that they have been used for program enhancements. You can probably see that by looking at the chart over there.

You will notice for the TPAF, the teachers' pension, in 1987-- First of all, the graph line with the blocks on it are the total assets of the fund. The liabilities of the fund are the basic benefits in the dark, and then the COLA is lightly shaded. The medical -- the postretirement medical -- is in the light. You can see that the total assets cover the liabilities in the case of both PERS and TPAF. But if you look back at 1987 and 1986, you will see that in 1986 the level of plan assets was above the basic pension liabilities, so in 1987, the plans were enhanced by adding on the postretirement medical and the cost of living. That happened under PERS in 1988. You can see those being added onto the basic benefits in that year.

Prior to that, there were substantial excess assets, if you will, assets well over and above the level of basic pension funding. Then, at that time, enhancements were made which used up that extra fund balance.

SENATOR SCHLUTER: When you talk about enhancements, Mr. Clymer, are you talking about the postretirement benefits and the COLA only?

TREASURER CLYMER: No, it could be anything. Enhancements could be in terms of changing the assumptions, in terms of cost of living, changing the assumptions in terms of future salary increases. There are any number of things that would cause more dollars to go into -- or more benefits to be paid out of the plan in the future.

SENATOR SCHLUTER: I'm getting a little bit afield and I may show my ignorance in this general area. This has nothing to do with the State Health Benefits Plan and the funding of the State Health Benefits Plan?

TREASURER CLYMER: That is correct.

SENATOR SCHLUTER: Okay. Is there a presumption, or is there a policy that perhaps if the employer/employee contributions are lower or tightened, that there will not be a tendency for public employee unions perhaps to, at some future date, use that excess, or the excess contributions for other benefits other than the pension benefits, such as (indiscernible) benefits?

TREASURER CLYMER: I am not sure I follow your line of thinking there.

SENATOR SCHLUTER: It is a little bit convoluted, I would have to admit. There has been, of course, as you know-- The administration has,

under its new contract on medical benefits, asked for a managed care copay situation. Is there any linkage in policy on these two--

TREASURER CLYMER: No.

SENATOR INVERSO: I have some questions I wish to raise.

First of all, what I would like to hone in on is, as I indicated in my opening comments, where do we stand relative to what had been forecast by the Reform Act changes in terms of various measurements? The measurements I want to take a look at are the ratio of assets used in valuation to the liabilities relative to the various systems. Are we on target? Have we fallen behind?

The Reform Act, I am told, anticipated a reduction in that ratio. Has that anticipated reduction been on target? Are we doing worse or better? Where are we going? Where is the trend going. I know we are going into the third year where we have the experience review done. Is there anything now that is sending up a flag that says, "Maybe we have to take a look at some of the assumptions and make changes in the assumptions"?

Have everybody on the same page. I just want to go through the assumptions -- the changes that were made with the Reform Act. We reduced the level of prefunding of postretirement medical benefits for PERS and TPAF. We never did pick up the prefunding for the other systems that was anticipated. We reduced the recognition and funding of the COLAs. We changed the funding methodology from entry age normal to the projected unit credit method. We changed the employee contribution rates for PERS and TPAF -- as the Treasurer has indicated -- to a flat 5 percent. We reset the amortization period for the unfunded accrued liability to a period not to

exceed 40 years, with a 10-year kind of transition, and then I think we were leveling it out at 30 years. You can correct me on that.

We phased in recognition of revised mortality assumptions for TPAF. We established a fixed 4 percent inflation assumption for COLA liabilities, with a trigger that if inflation exceeded 4 percent for two consecutive years, we would make a change, and we established a fixed salary increase assumption through 1996.

So I guess my question is: In light of those changes, what has been the impact on the ratio of assets to liabilities, for instance? Bob, maybe you could start addressing that, and then from there I have other questions. I don't want to go through the whole routine right now.

MR. BAUS: Okay, sure.

With regard to the asset/liability comparison, I think, in general, as of 1995, which is the latest valuation studies that have been done, we are a little bit ahead of where we expected to be. In other words, funded ratios are slightly above where we had projected.

Now, since the reform was adopted, we had a not-so-great year of investment return, which we have already discussed. The funded ratio, at that point, was below -- a couple of percent below where we had anticipated.

SENATOR INVERSO: Could you just, for a second, give us the number that was anticipated and the number where we are, so we know the magnitude of what we are talking about?

MR. BAUS: Okay. I have the teachers' numbers in front of me. Maybe we can focus on them. In 1993, we were expecting to be at about 92.5

percent funded, and we were about at 93.5 percent, so we were just slightly above where we expected to be in 1993.

In 1994, we expected to be at about 93 percent, and we actually came in at about 87 percent. That was the poor investment year.

SENATOR INVERSO: Now, again, are we talking about funding -- the percentage funding being a measurement of the assets, the valuation assets, right, to the projected benefit obligation, the PBO?

MR. BAUS: What we are talking about is the market value of assets.

SENATOR INVERSO: Now, wait. The total market value or the valuation?

MR. BAUS: The market value of assets.

SENATOR INVERSO: Okay, so the total value of the assets--

MR. BAUS: Versus the PBO -- the projected benefit obligation.

SENATOR INVERSO: Versus the PBO.

MR. BAUS: Correct.

SENATOR INVERSO: Okay.

MR. BAUS: Then in 1995, we were virtually exactly where we expected to be, which, again, is about 93 percent. We are estimating in 1996 that we will be about 2 percent to 3 percent higher than we had projected.

SENATOR INVERSO: Bob, can you give me that information in tabular form, because I am having trouble. The information I have here from the actuarial report for the year has the funded percentage comparing the PBO to the net assets available for benefits on a valuation basis, which is less than the market value. I need to have apples and apples, quite honestly.

MR. BAUS: That is the GASBY. The Government Accounting Standard Board Requirement used the valuation assets. That is why it is presented in the report in that manner.

SENATOR INVERSO: In the report that way, right.

MR. BAUS: That is correct.

SENATOR INVERSO: But I have it this way. Now, give it to me the other way, because-- Am I correct? In the report here, obviously I am correct, because you have the number in front of me. But the valuation assets were \$16.3 billion, but the market value of those assets was about \$17.4 billion.

MR. BAUS: That is correct. Those are the right numbers.

SENATOR INVERSO: Right, okay. So we have about a billion or so difference between the valuation assets and the market value of the assets. The PBO will not change, obviously.

MR. BAUS: No, that is about \$18.9 billion.

SENATOR INVERSO: All right, that is why the 86.6 percentage funded in this table here is less than the 93 percent, because you have a billion more that we are using in our measurement.

MR. BAUS: That is correct. And the important thing here, Senator, is that the study that was done in the (indiscernible) form that was under consideration, was using the traditional market value to PBO analysis. So if you go back to the charts and the studies that were done, that was the comparison being made back then. That is why we are doing it this way today, so it is consistent.

SENATOR INVERSO: Well, this is not to say, you know, you are a great actuary or you are a lesser great actuary, but I would like to see what we have projected compared to what it is now. Again, it is the trend. We know when you have an off year with investments, that that is going to affect the measurements. But, again, the key thing here is trending, not so much are we testing you as an actuary. Bob, I think you understand that.

MR. BAUS: Yes. Well, essentially, what the forecast anticipated was that there would be some erosion in the funded level for about six or seven years, and then the funded levels would come back up. We are seeing some of that erosion, but we are actually ahead of the game. We are actually not eroding as far as we expected to based on just the first couple of years.

SENATOR INVERSO: All right, so that is to our favor.

MR. BAUS: That is a positive picture.

SENATOR INVERSO: That is to our favor.

MR. BAUS: That is correct.

SENATOR INVERSO: Can you explain for me-- For those of you in the audience, I am trying not to get too technical on these things, because I do not have the expertise. But there are some questions that have arisen as a result of reviewing some of the material I have.

In the TPAF, Bob, you started out with an unfunded accrued liability credit, in essence, which is the opposite of what you normally come to expect. I presume that credit arose as a result of the Reform Act, the recasting of the actuarial method, and so on. We started out with \$671 million as of March 31, 1994. We would have expected to have \$556 million, according to your chart, but we end up with only \$289 million. So, in essence, we had a

\$266 million actuarial loss in that category. That gives rise to your total \$98 million loss as shown on your actuarial report.

What caused that 50 percent loss of that surplus that we had in the unfunded accrued liability or credit balance? Are you with me on that?

MR. BAUS: Yes.

SENATOR INVERSO: Okay. It is on page 13 of your report. You know, I didn't know how to interpret that when I was reviewing it.

MR. BAUS: There are a number of things that happened between valuation that can cause this erosion. In fact, in the report, we do not do this in dollar terms, we do it in percents. We give you some indication of what the gains and the losses are from year to year.

So, for example, in the year you are talking about, that is the year when the investments were slightly below what we expected. So we got, in this case, not more liability, but less assets than we might have anticipated. So there was a slight loss on account of that.

SENATOR INVERSO: I'm talking about the accrued liability, not necessarily the-- Are we talking about the same thing? When I say the "unfunded accrued liability," that is the liability number. That has nothing to do with the assets.

MR. BAUS: Yes, it does. What you have is, you have the total assets of the system to start with. You take out the assets that you have on hand. That gives you the unfunded accrued liability number. So we expected that to be a credit of \$670 million, and it actually -- or \$556 million, and it actually came out to \$289 million, which means that we had a loss of a couple of hundred million dollars.

What I am saying is, part of that calculation is that the assets were not quite as high as we anticipated they would be, so with less assets the unfunded is greater, which means that you eat into the credit balance. That is part of what happened.

SENATOR INVERSO: That was a significant part of what happened. That's 50 percent.

MR. BAUS: Well, it was about 10 percent, I guess, of the adjustment. That is just--

SENATOR INVERSO: That is your table on page 14.

MR. BAUS: Yes, page 14.

Now, we have a built-in loss in the system when individuals retire from one year to the next, because of the way we fund the COLA. That is going to generate a loss each year until the phase-in becomes substantial, close to 100 percent. So that is another 10 percent, basically, of the shortfall.

SENATOR INVERSO: All right. So the valuation report for this coming year -- or the year that will be coming--

MR. BAUS: Year 1996.

SENATOR INVERSO: --1996, because of the substantial investment gains, we should see this thing, in essence, reverse itself, I would think.

MR. BAUS: Yes. The only built-in loss-- I believe there is one more year to go on the phase-in of the actuarial assumptions. So that loss has to be overcome.

SENATOR INVERSO: That is the .63 percent.

MR. BAUS: That is the major change, yes. That is the major increase. Aside from that, though, given that we know the investments have done well, yes, I would hopefully see that you are going to see some gain this year, as opposed to a loss.

SENATOR INVERSO: Okay. So that explains that.

Under the other systems, Bob, how are we faring?

MR. BAUS: The PERS local had a relatively small loss this year, about \$45 million. The State had a loss of \$155 million. So the experience in both cases has been negative.

One of the big things that happened on the State employees, is that we had fairly substantial pay raises this year. That generated about a third of the loss.

SENATOR INVERSO: In PERS?

MR. BAUS: State PERS.

SENATOR INVERSO: State PERS.

MR. BAUS: The State piece.

SENATOR INVERSO: The State piece?

MR. BAUS: Yes, we separate the State and the locals in doing valuation.

SENATOR INVERSO: You say we had a substantial pay increase in the State piece?

MR. BAUS: You had pay increases that were in--

SENATOR INVERSO: What period are we talking about? Are we talking about Fiscal 1995?

MR. BAUS: That is correct. Yes, we had pay increases that were significantly above-- Again, going back to teachers, the pay increases were right about where we expected them to be. There really wasn't a gain or loss from that source, from teachers. In State PERS, that was not the case. We saw about a third of this loss coming from the size of the salary increases.

SENATOR INVERSO: So, again, Bob, we had a spread of about 2.8 percent. We saw that spread diminish because of--

MR. BAUS: Yes, just for State PERS though. The locals, again, were very, very close to what we were expecting. But for State PERS for this year, there were substantial excess increases.

SENATOR INVERSO: Very substantial increases?

MR. BAUS: Yes, they were.

SENATOR INVERSO: But if you asked the typical State employee if their increase was substantial, they would disagree with you. Did anyone look at that phenomenon -- what might have caused that phenomenon?

MR. BAUS: Well, we haven't, no. One of the things you have to keep in mind is that we had windows operating during this time. It may be that the people who went out through the window processes generated promotions for people to fill those slots. We really haven't done an analysis that says that is the case.

SENATOR INVERSO: You know, just thinking about it goes against what we have been trying to achieve by early retirement, buyouts, and so on. We had two over the last five years.

MR. BAUS: Well, it may or it may not. I mean, if the net population is decreased, then you are getting to where you want to be. I mean, I think you have to recognize that if you let senior people go, those positions are probably going to have to be filled. However, the hope is that they will be filled through promotion, and then there is not a replacement.

SENATOR INVERSO: We were hoping that with retirements, if replacement were to occur, it would occur at a lower starting level.

MR. BAUS: Yes.

TREASURER CLYMER: Generally, they haven't worked.

SENATOR INVERSO: Yes.

TREASURER CLYMER: By the time you take the future pension payments and tie them back into the present, you have a net loss, not a net gain.

SENATOR INVERSO: What about our postretirement medical benefits funding? Are we on target there? It is supposed to be, what, one year's premium plus one-half of 1 percent of salary? We are conforming with that, right?

MR. BAUS: Yes. That asset is growing the way it is required to grow under the law. Obviously, as Roland does well with the investments, there are less actual contributions due in, but that asset base is continuing to grow, just like the fact that we are paying the benefits out.

SENATOR INVERSO: One of the things that we had accepted when we looked at the Reform Act was the potential that there would be national health insurance, or some national program coming out of Washington, and a lessening of the inflationary increases we had experienced

in the health field. The latter did occur. That clearly went down considerably. I think we are down to about what, 5 percent or so, or 6 percent?

MR. BAUS: It is 5 percent nationally. I think it has actually been negative here in New Jersey for the last two years.

SENATOR INVERSO: That has occurred and, of course, we have not seen any national policy on health out of Washington.

I was one of the people who felt we should not have abandoned the prefunding of the health benefits, so we ended up with some compromise to provide for some prefunding.

In view of the fact that we do not have what we were anticipating, when you do your experience review, Bob, which is for, what, this coming year-- When will that be done, by the way? I just want to get my dates straight. When are you going to be doing that experience?

MR. BAUS: I believe the Public Employees' Retirement System's study is due this year, 1996, and I believe the teachers is due next year, 1997.

SENATOR INVERSO: Next year? Okay.

I am just wondering whether you will take a look at that or do you need to have direction to take a look at that, in terms of whether-- That becomes an administration policy. It is not an actuarial policy. You can implement whatever the policy is, I suppose.

MR. BAUS: I believe as far as the review itself is concerned, we will take direction from the boards. If they want to include it, we will be happy to. If they do not want to-- I mean, experience does not do a lot here with regard to the way it is being funded at this point. So, you know, all things

being equal, you wouldn't necessarily look at it. But certainly from an educational or informational standpoint, it could be examined.

SENATOR INVERSO: Again, just to put it on the record, is New Jersey in the pack of states with regard to how they are treating their postretirement benefits, or are we out of the pack?

MR. BAUS: No, you're out of the pack, in front still, because there are virtually no other states that are doing any prefunding at all.

SENATOR INVERSO: So even though we have modified ours and made it maybe, I would say, a little less aggressive than it was, we are still unique, in that a lot of states are not recognizing this obligation.

MR. BAUS: That is correct. I don't know that you are unique, but there are certainly not more than--

SENATOR INVERSO: We will let them think that we are unique in New Jersey, though.

MR. BAUS: Not more than a handful of states are doing anything in this area right now.

SENATOR INVERSO: Do you see anything where GASBY may require that?

MR. BAUS: That is a different issue. I mean, GASBY addresses the accounting side of it, as opposed to the funding. Yes, for sure you are going to have to disclose these liabilities. I mean, I think in Fiscal Year 1997 you will be looking at disclosing all the pension liabilities. It is either that year or shortly thereafter that you will be disclosing other liabilities also. So from an accounting standpoint, for sure you are going to deal with this.

SENATOR INVERSO: From a funding standpoint, then, it is something that, again, becomes a policy decision, depending upon the circumstances at the time.

What about our level of COLA funding? Are we on target relative to the assumptions that were made two years ago?

MR. BAUS: Yes. I think the good news on COLA is that inflation has been down, so even with the change in the long-term inflation assumption we made as part of the reform, you have actually -- the systems have actually had gains in the last two or three years, because the actual adjustments are lower than what we were even anticipating at this point.

SENATOR INVERSO: The increases we have seen in the contribution rate, for instance, PERS-- We are up to 1.85 percent, and what were we, .63, was it? Yes, I have here .63 to .183 -- or 1.83, PERS. It says right here, "An increase in the total contribution rate to fund the retirement system from .63 percent of compensation to 1.83 percent of compensation." That's TPAF. I'm sorry. PERS is from .98 to 1.85. So those jumps, Bob, are basically the result of the investment, or actuarial losses that have occurred?

MR. BAUS: Yes. Well, it is a combination of things. The majority of them are the experience of the systems from one year to the next. But what you also have to recognize is that we anticipated some significant increases because of the phase-in of the assumptions. I mean, part of the reform was to fund -- was to phase in the assumption changes for teachers over five years, and we are phasing in PERS over three years. It is a given that those increases are going to take place, so there was an anticipation that there would be some increase until the assumptions are fully recognized.

Beyond that, yes, in total the experience the last couple of years has not been positive, so there is some increase from that also.

SENATOR INVERSO: So the contribution rates have increased because of what you have cited. But the contributions that will result as a result of these rate increases, are they in line with what you had anticipated?

MR. BAUS: I think the experience was not anticipated in the forecast, the phase in of the assumptions was. So the answer, I guess, is yes or no, depending on which piece you look at. But certainly the phase in of the assumptions-- We anticipated there would be an increase in percent and dollars. To the extent the experience and aggregate have not been positive, that is an unexpected increase.

SENATOR INVERSO: Okay. So it means that our contribution -- the State's contribution -- to the pension system will increase a little more than we had anticipated. Again, it is not an indictment, it is just that it will be a bit higher because of that.

MR. BAUS: It has already and, yes, it will continue to be. Well, I say it will continue to be if the experience becomes very positive and they reverse the trend.

SENATOR INVERSO: Right, and the TPAF has really jumped. I mean, it has gone up three times -- threefold, I should say.

MR. BAUS: That is correct, but that-- If you look at this past year's experience, the step in the assumption -- phasing in the assumptions was 63 bases points, so that is a large step. That will be finished now, and you won't see that kind of step as you go through in the future.

SENATOR INVERSO: Okay, that will come down a little bit.

MR. BAUS: Senator, it might be just of interest to make the comment that I think in the long run we are expecting the system's costs to run in the 6 percent or so area as far as contributions. I mean, as we get the COLA fully recognized in the funding process, we anticipate the contributions ultimately are going to be up in the area of 6 percent. So, over time, including the COLA, that is where we are heading. That's long term, but that is where we're going.

SENATOR INVERSO: Does that include postretirement medical, Bob, or just the normal pension benefit -- the 6 percent?

MR. BAUS: I remember that 6 percent to 7 percent range. Actually, I am not sure.

SENATOR INVERSO: Okay, so it may or may not include the postretirement.

When do you think we would hit that plateau?

MR. BAUS: Well, we are only at -- in the high 20s as far as the phase-in on the COLA is concerned, so we have about 25 or more years to go still before it gets up there as a result of the phase-in.

SENATOR INVERSO: Twenty-five more years to go before we would hit the 6 percent?

MR. BAUS: Yes, all other things being equal.

SENATOR INVERSO: Everything being equal, yes, employee turnover and anything else that goes into that rate.

MR. BAUS: Right.

SENATOR INVERSO: Bob, before the Governor's reform, we had about a \$2 billion-- In the early 1990s, I think, we had about a \$2 billion

unfunded liability in-- Let's see, where is your letter here? Yes, here it is, okay.

The aggregate unfunded liability of the pension systems was around -- or in excess of \$2 billion in the early 1990s.

MR. BAUS: Between \$2 billion and \$3 billion, yes.

SENATOR INVERSO: Okay. I am looking at your letter to the Treasurer that you provided me. This is getting to the point that was raised in an article that appeared in the "New Jersey Reporter," that the liability has gone from \$800 million in 1993 to \$4.7 billion last year.

Do you want to respond to that? I have read your description here. My understanding is that there was a surplus that was derived from the Reform Act by going through with the changes to the actuarial method and, you know, reducing the prefunding of the health benefits and the COLA thing changes, so that there was really a surplus, or a credit that originated. So the \$2 billion, in essence -- or the \$3 billion, whatever the number is -- came down to about \$800 million -- is that what you're saying? -- and that therefore--

MR. BAUS: That is correct.

SENATOR INVERSO: But are we at \$4.7 billion now?

MR. BAUS: I believe that is correct, yes.

SENATOR INVERSO: Okay. So if I want to compare apples and apples, do I take-- If I were at \$2 billion in 1990 -- all right? -- and that really, because of the Reform Act, became \$800 million around 1992-- Let's say -- let's just use those two numbers. If I had a \$1.2 billion credit, or surplus, that I applied, the \$4.7 billion that was used in the article did not reflect the Reform Act surplus, or credit. Is that what you're saying?

MR. BAUS: Well, no. I believe what has happened here is that we were at a point of \$2 billion, or \$2.5 billion -- whatever billion dollars -- of unfunded in the early 1990s. Then the reform came in and with the surplus we artificially reduced the unfunded, and that is the \$800 million number. We are now up to \$4.7 billion. I think the two points I probably made in the letter were that the comparison of the \$800 million to the \$4.7 billion was a little bit artificial, because the \$800 million was artificial.

SENATOR INVERSO: When you say "artificial" -- just so we understand why you're saying -- it really never appeared, but if you took the previous number and made actuarial changes that lowered the unfunded liability--

MR. BAUS: Temporarily, correct.

SENATOR INVERSO: Okay.

MR. BAUS: When we did the projections, the forecasting studies, back then-- If you take a look at those results, you are going to find that we expected the unfunded to grow for a period of time. I mean, if for no other reason than that the cost-of-living adjustments at the current funding level were not maintaining the unfunded there. We were actually losing some ground until that phase-in got up to a higher level. So the projections anticipated in increasing the unfunded for a period of time, I believe until about 2008, 2010.

SENATOR INVERSO: But is the increase in the unfunded due to expanding the liability component, or a combination of expanding the liability component and reducing the asset growth?

MR. BAUS: The growth in the unfunded-- Well, basically it comes from two places. It reflects the current level of funding, number one, the fact that we did reform and we did reduce the contribution level. Number two, it reflects the experience of the system, what is actually happening since the reform was adopted. As I said before, we have had some negative years in aggregate, and that means the liabilities are higher than we expected. That goes right into the unfunded.

SENATOR INVERSO: Okay. So when we did the reform, we anticipated a fairly-- That is a fairly large increase.

MR. BAUS: Well, we anticipate that it is going to be bigger than that at some point. As you go through time, as I said, I think until about 2006 or 2008, we expect that number to grow. So it is going to get bigger. It does not change the fact that the system is funded, you know. It is a funding number in the funding equation.

SENATOR INVERSO: But it is an unfunded liability growth, which means-- Does that mean, to the layman-- I'm sitting out there and I say, "I had a system that had an unfunded liability of" -- you say artificial, but, okay -- "let's say \$800 million. It has not gone up to \$4 billion."

MR. BAUS: Yes.

SENATOR INVERSO: That frightens me. How do I respond to that?

MR. BAUS: It is not an unfunded in the sense of a security issue of the benefits from the participants' standpoint. It does not mean that there is not money there to pay their benefits. What it means is, when we apply the funding formula, the methodology, you know, you are either in a surplus or a

deficit from a funding standpoint. What that means is that there is money that has to be paid in to make that up at some point in the future. It does not mean that there is not money enough to cover the liabilities right now. There is more than enough.

SENATOR INVERSO: Well, that is essential. That is a key point, that the obligations of the plan now are being fully met, because the assets are there to meet them.

TREASURER CLYMER: That is the part of the chart that--

MR. BAUS: Yes. It is interesting, I think, to note on the charts again, if you go back, as the Treasurer said, back to the mid-1980s, we were not recognizing all the benefits that ultimately were due. The COLA and the postretirement medical are not there.

If you take a look at those liability numbers, they more than tripled in the last 10 years under the big systems. But the assets are still meeting the liability requirements, so we still have enough money, even though those liabilities have tripled, to cover them with the current assets. So there is no unfunded from the standpoint of the security issue.

SENATOR INVERSO: Where are those charts we had, those three charts? I think I put them in here. One of those I wanted to raise.

I guess this is the time to throw this out now. I was a bit staggered when I looked at some of the charts here. I am looking at a chart, I guess that came out of your valuation report. Historical funded status, State PERS liabilities: In 1986-- Do you have that chart?

MR. BAUS: Yes.

SENATOR INVERSO: In 1986, we had a liability in the PERS system of \$2.2 billion. At the end of 1995, I have \$6 billion of liability built up. That consists of my: vested retired, my vested deferred, vested active, nonvested, and there is the component in there of future salary growth.

If this were my business, I would say, "Oh my God." This is overwhelming. How do I accommodate this? When I look at the TPAF, I am looking at, in 1986, \$6.8 billion of liabilities. You jumped in 1987 to \$10 billion, because I put COLA in there, and at the end of 1995, almost \$19 billion in liabilities -- a threefold growth again.

What's happening? People are staying in the system, salaries going up, we're liberalizing the benefits. What would you say, Bob, as an actuary? All of the above, and others that I--

MR. BAUS: Well, yes. I mean, clearly we have picked up-- Since 1986, we picked up future liabilities for COLA and postretirement medical, depending on which charts you are looking at. We have also had windows that generate liabilities with no assets initially.

SENATOR INVERSO: Would you explain the windows, Bob?

MR. BAUS: Sure. Windows are short-term incentives that are designed to encourage people to retire, so it really focuses on the older, longer-service people who are at eligibility -- who are already at the eligibility to retire, or very close to it. What you do is set up an incentive. The windows we used here typically add service or provide medical benefits, so that they either increase the pension or cover people for medical who are not otherwise covered, with the thought that with that additional extra benefit -- whatever it might be -- people will decide to retire who might not otherwise have retired,

the thought being that you reduce the overall population as a result of that -- increase the efficiency of government and reduce the population that--

SENATOR INVERSO: So our two early retirement programs, in effect, caused the two windows.

MR. BAUS: Yes.

SENATOR INVERSO: And you have identified that as a separate category and you are actuarially dealing with that as a separate--

MR. BAUS: Yes. For the State, we identified separately, and for the locals we identified each local's liability and they paid for it themselves.

SENATOR INVERSO: Just to throw out another chart here-- I mean, I am just throwing it out because, maybe to set a mood or maybe just to recognize what we are dealing with here. I am looking at the police and firemen's retirement system. In 1985, we had a pension benefit obligation of \$2.5 billion. It is up to \$9.9 billion. That is almost \$10 billion, almost a fourfold increase.

My specialists here tell me that the key thing is that you have to look at the percentage funded, but that is even going in a different direction. In 1985, we were almost 100 percent funded, and we dropped down to about 81 percent funded in 1994. So my obligation is growing and my percentage of funding-- Not because of the Reform Act. It is just a matter of-- I mean, in 1988, we were only 76 percent funded. Then we went into market valuation and the funding percentage improved. In 1991, we were up to about 96 percent, and now we are down to 80.9 percent.

You know, as a legislator, as a Senator, I mean, I find this frightening, to some extent. I mean, overwhelming, to some extent. We have

a lot of future costs that we have to start dealing with. Am I being too much of an alarmist, Bob? Please help me, because I--

MR. BAUS: This is the point, I guess, that I was trying to make before, Senator. What you are talking about are the bars. You can see how the bars have gone up threefold.

SENATOR INVERSO: Right.

MR. BAUS: This is just teachers and PERS. But one of the keys to why this has happened is the COLA recognition under the system. In teachers, between 1986 and 1987, you can see how that bar jumped. The same thing with PERS in 1988. When we pick those liabilities up, we pick up no assets. It just means that you are going to recognize the obligation that you have.

To me, the interesting thing is, if you go back to 1986 or 1987, depending on which system, you can see that we had a surplus of assets, ignoring the COLA obligations you had. Okay? Now, having recognized the COLA obligations, if you come forward to 1995, we have already got enough money to cover that. That is pretty impressive, I think, in that 10-year period to take that obligation on and to now be in a position, at least on an ABO basis where you have that liability covered, it means you are taking care, from a security standpoint -- you are taking care of the obligations.

SENATOR INVERSO: That is under the GASBY?

MR. BAUS: Yes, that's right.

SENATOR INVERSO: Or the ABO, right?

MR. BAUS: Yes, that's right. It doesn't anticipate what is going to happen in the future, so that unfunded that you are talking about -- the

\$800 million or \$4.7 billion -- is in the funding formula. It is not the assets versus what you owe right now.

SENATOR INVERSO: Right, right.

Bob, in this regard, I said we are unique, but we are not unique, though, in this regard with respect to other governmental, Statemental (sic) systems -- correct? -- in that the liabilities are growing at an alarming rate, and you think we are doing a better job in terms of keeping the assets at a point where we are not falling so far away from the relationship that should be maintained over appropriate assets. And our assets at market value are greater than the liabilities under the PBO method for all the systems, or is it only the TPAF?

MR. BAUS: No, no. I think on a PBO basis, you are probably running in the 90s, you are about 90 percent or so funded overall.

SENATOR INVERSO: Overall.

MR. BAUS: You are certainly at 100 percent or better on an ABO basis, but I think you are probably running in the 90s on a PBO basis.

SENATOR INVERSO: But TPAF we were 100 percent.

MR. BAUS: Yes. Well, you can see it here, if you look at 1995.

SENATOR INVERSO: There it is, 100 percent.

MR. BAUS: I'm sorry, those are ABO numbers on there. Those are ABO numbers. But if you look at on a PBO basis, instead of 100 percent, you would be running about 93 percent, I think, on teachers.

SENATOR INVERSO: Okay. On the PBO?

MR. BAUS: Yes, on a PBO basis.

SENATOR INVERSO: But ABO we are over 100 percent on.

MR. BAUS: Yes. In fact, you are about 115 percent or 120 percent on PERS, and you are 100 percent-plus on teachers.

SENATOR INVERSO: Again, to clarify, should we be looking at ABO, PBO, or where should we be? I mean, we are kicking these terms out there, but where should we be? That is an argument that--

MR. BAUS: Well, that's an excellent question. If you go back to 1989 when we did the big study, the big funding policy study that has been alluded to--

SENATOR INVERSO: I'm sorry.

MR. BAUS: That's okay.

If you go back to 1989 when we did the big technical study of funding policy, at that point, I think pretty much in the industry -- in the State industry, the public sector, people were looking at ABO, so when we did the analysis back then we did it on an APO basis. But asking the question today, I think pretty much everybody has come around to the idea that PBO is probably a better measure of the obligation of the system.

Having said that, if you go back to the study we did in 1989, what we were suggesting back then was that you would want to be, like, 130 percent or so funded on an ABO basis, whereas today we are saying you ought to be 100 percent or so funded on a PBO basis. That is really the same answer. It is just two different descriptions of the same results. I think you are probably better off looking at PBO today, as long as you understand what it is that it represents.

SENATOR INVERSO: Someone whispered in my ear that maybe we ought to indicate what PBO and ABO mean. There may be people out

there who do not know. I thought I knew, and I keep wondering again. Go ahead. Go through it again.

MR. BAUS: Okay. ABO is short for accumulated benefit obligation. In simplest terms, it is like a planned termination calculation. It says what benefits have been accumulated to date, what the value of them is. If you shut the plan down, really, what are your obligations?

PBO is the same calculation, except that for the active group, instead of looking at current salaries, which is what you would look at on a termination basis, you look at projected salaries when individuals are expected to retire. So the PBO is a bigger number, because you are projecting pays in the calculation, and it probably runs 20 percent or 30 percent higher than the ABO number.

SENATOR INVERSO: But the ABO also excludes your nonvested employees. Is that correct?

MR. BAUS: No, no. The ABO includes them. To the extent that they have a benefit accumulated, it is included in that calculation. Obviously, it is not vested at this point, but you do include the accumulated benefit value for nonvested people. Everybody goes into the ABO calculation.

SENATOR INVERSO: Everyone is in the ABO?

MR. BAUS: Everybody, yes.

SENATOR INVERSO: Okay. I thought they were excluded.

MR. BAUS: No.

SENATOR INVERSO: They're in there. So the only difference between the ABO and the PBO is the question of the future salary progression?

MR. BAUS: That is correct.

SENATOR INVERSO: Both exclude medical, obviously. We are not talking medical.

MR. BAUS: Well, yes. They either include or exclude, but you have to say it. But generally speaking, at this point, the way the GASBY rules have come down, they exclude the medical. We run both. When we do the reports, we run them with and without so you have some sense.

This issue of vesting, you are probably thinking of the vested benefit obligation. That would exclude the nonvested, but that doesn't get into any of these numbers anymore. We don't do that.

SENATOR INVERSO: No, I'm talking about ABO. I thought, under ABO, that they excluded the nonvested category until such time as they were vested.

MR. BAUS: No.

TREASURER CLYMER: In the other chart we did, Senator, the one on the floor there, we did include the medical benefit as well to show that the assets had exceeded the liability.

SENATOR INVERSO: Oh, you have it in here, yes.

MS. McMAHON: Yes, it is in there.

SENATOR INVERSO: Which is a conservative way, if you will. I guess it is not conservative, but perhaps it is a candid way of showing it.

TREASURER CLYMER: If you look, Senator, at the 1994 State of Wisconsin comparative study of the major public employee retirement systems, according to them at that time, the average PBO funding level was 85.53 and TPAF, for us, was at 87.6 and PERS at 105.2. So, on a comparative basis, we were better and above the average.

SENATOR INVERSO: There has been some concern that our actuarial assumptions are not appropriate concerning the aging of the participants, particularly with regard to the TPAF. Can you respond to that as to whether we are on target with regard to the aging of that group or whether we are not on target?

MR. BAUS: Yes. We took a look at the last three or four years as far as the valuation date is concerned that we get for the teachers' valuation. Since 1992, the average age has gone up from 45.1 years to 45.3 years. We do not think that is a very significant issue, or statistic. The average service of the individuals has gone up from 15.5 years to 15.6 years. Again, that is not very significant statistically.

So I am not sure of the source of that suggestion, but it is certainly not reflected in the data we are receiving for valuations.

SENATOR INVERSO: What about in terms of the longevity or mortality of the retirees? Is that something that we are on target with?

MR. BAUS: No question. People are living longer. Retirees are living longer. That is one of the issues we addressed in the last experience study that was done for teachers. We suggested an update to the table, because we expected, or anticipated that there was going to be further improvement. The actual experience was tracking fairly closely to the table we were using at the time, but we, nevertheless, suggested a newer -- that a more modern table be used. That is the table that is being phased in over five years, so we will be fully recognizing the new table starting with the 1997 valuation. I think we will be at least even, if not a little bit ahead of the game with regard to participant mortality.

Obviously, we are going to look at this again for the Public Employees Retirement System this year as part of the experience review.

SENATOR INVERSO: Bob, the other thing I wanted you to address is, by way of clarification-- The article alluded to earlier mentioned that it was projected that we were going to pay \$100 million into the TPAF fund system in this fiscal year, that we are actually paying \$189 million into the system. Do you want to touch on that?

MR. BAUS: Yes, there is a little bit of a misunderstanding, I think, on the part of the "Reporter." We projected a pension contribution for the current year of about \$85 million for teachers. The actual contribution turned out, I think, to be about \$67 million. So from a pension standpoint, we are actually a little bit ahead of the game. We are a little bit less than where we anticipated being this year. The confusion arises from the medical side. The number of \$189 million is correct, but that includes \$122 million of postretirement medical premium contributions. That was never part of any of the projections we did. So you have to back that piece out of the \$189 million to get an apples to apples comparison.

So I think we are fairly close to where we expected to be, maybe a little bit ahead of the game.

SENATOR INVERSO: Okay. So it is the medical component of that. That medical component was the one-year, pay-as-you-go, I guess.

MR. BAUS: Plus the .5 percent increase in the balance, that's right.

SENATOR INVERSO: Technical question on that: Actuarially, you are netting from that .5 percent the investment income, the interest earned on the fund. Correct?

MR. BAUS: That is correct.

SENATOR INVERSO: Was that stipulated in the legislation?

MR. BAUS: That is my understanding. I spoke to some people, actually, before we did the first valuation. It is my understanding of what the words in the legislation said, yes.

SENATOR INVERSO: Okay. Well, we will have to check that.

MR. VOLZ: (OLS Staff) It is.

SENATOR INVERSO: It is? Well, Brian tells me it is, so you are in accord with OLS.

MR. BAUS: I mean, I will be honest with you. The first time I did the numbers, I didn't do them that way, but--

SENATOR INVERSO: You didn't do it that way, right. I would not have done it that way either.

So, as that fund grows-- Well, the fund can't grow too much. It basically has to contain one year's premium, right?

MR. BAUS: Yes. It is not going to grow dramatically, that's for sure.

SENATOR INVERSO: The rate of contribution to the individual systems that the State makes varies from -- now it will be 1.83 percent for TPAF to 1.85 for PERS to 19.2 percent for the police and firemen, and 30.5 percent for the State Police. This is not something, I guess, that you can answer. I am just throwing it out there because when you look at it, you say,

“Why this significant disparity?” I guess you have to take a look at what the systems provide and, I guess, some of the history and the politics behind it all.

The employee contribution rate for TPAF and PERS is 5 percent, and the employee contribution rate for police and firemen is 8.5 percent, and for State Police is 7.5 percent. You know, when you look at this, quite honestly, one can understand where-- You know, people who participate in, say, the PERS system, are saying, “Hey, you know, I am contributing 5 percent, the State is contributing 1.85 percent. I mean, whose pension system is it? I am contributing almost three times what the State is contributing.” It is almost like a 401K with a match, except that you can’t draw it out.

I don’t know what my question is on this, other than an observation. There is a decided disparity. I was thinking going forward that maybe we ought to consider a defined contribution kind of plan. But it would strike me that that could be very expensive, in view of these percentages.

Brian, I mean--

TREASURER CLYMER: Not necessarily.

SENATOR INVERSO: Not necessarily, is that what you said?

TREASURER CLYMER: No. Many companies are converting over to defined contribution plans. You hear of the defined ones going in and know about having to take into consideration the uncertainties of market risk and change in investment rate over the long term. All that risk, basically, goes to the beneficiaries.

SENATOR INVERSO: To the individuals.

TREASURER CLYMER: Yes.

SENATOR INVERSO: I mean, clearly in the private sector this is the direction. I am sure Bob can tell us better, but this is the direction companies have gone in.

TREASURER CLYMER: The advantage, of course, is that you can define, obviously, your contribution. If you know what your contribution is going to be, it becomes a relatively stable part of your budget from year to year.

SENATOR INVERSO: And the employee can control the investment decisions for the most part.

TREASURER CLYMER: With a defined benefit, you are subject to a myriad of assumptions that can vary from year to year: the ages of your employees as employees come and go; the investment experience, whether you have a good year or a bad year; just a lot of factors that can affect your payment -- one one year, down another. We do employ smoothing techniques to try to blend the rates so that we have big increases, and years that aren't so bad, they are blended in. You pick that up over a period of three, four, or five years, so you smooth out some of those problems. But there are a lot more uncertainties.

SENATOR INVERSO: So it is something that would not necessarily have to be discounted out of hand because of the costs.

TREASURER CLYMER: Oh, no, no, no. We are much better off where we are. We have a solidly funded plan, amounts that will go up as we expect them to, but they will go up at a much more controlled pace than they would have before reform.

SENATOR INVERSO: Brian, or Marge, is the disparity in the State's contribution rates between the systems here -- you know, with the State

Police and the police and firemen being so high -- a function of the benefits, if you will, of the richest of the plans? Is that fundamentally what it is?

MS. McMAHON: Absolutely, yes. But I would add that it is not unusual to have individuals in the police and fire system have a pension benefit that is greater than public employees, the philosophy being that they put their lives on the line.

SENATOR INVERSO: The risk element there, yes. It is part of their compensation.

MS. McMAHON: The risk element. So that it is not unusual.

SENATOR INVERSO: It is not unusual.

I don't know, again, whether it is meaningful to compare this with what other states are making in terms of their contributions to the various systems, but, I mean, it strikes me that both of those systems are certainly well-endowed systems, and the State's contributions to the systems is fairly significant when you look at them in terms of the other contributions.

A couple of questions here are relative, too. We have no control, really, over the teachers' salaries. That is something that is negotiated locally, but we do have the obligation to pay both Social Security and pensions. That makes it kind of one of those uncontrollable situations where you say, you know, "I am not involved in determining what the costs will be, but I have exposure at the other end."

TREASURER CLYMER: Well, it certainly makes it much easier to grant raises at a local level, or to hire people, when you don't have to worry about paying for the fringe benefits.

SENATOR INVERSO: Brian, I am told you have to leave in a few minutes.

TREASURER CLYMER: I still have about 10 minutes or so.

SENATOR INVERSO: But can the rest of the people stay? I think we have a few more questions.

TREASURER CLYMER: Oh, yes, absolutely.

ENATOR INVERSO: Bill, chime in with a question at any time while I am fiddling with my papers.

SENATOR SCHLUTER: I am in awe of your knowledge of this, Mr. Chairman.

SENATOR INVERSO: Oh, no, it is not knowledge. It is easy to ask questions. It is the answers that are hard to come by.

I guess maybe, at this point, we can have the other people who are scheduled to make comments, make their comments, and then we will have some questions from that. Then we will see if we can bring some closure.

We do have another aspect of this hearing. We want to touch briefly on the legislation that has been introduced to codify its statute, the agreement with the Internal Revenue Service.

As you know, I introduced a bill, and there is a bill introduced by, I guess it was Senator Kenny, and the Democrats, seeking to do the same thing. His bill has some other provisions in it relative to property rights, the granting of contractual property rights to the participants of the plans, which I understand the unions want to mention today. We are not going to reach closure on that issue today. We are going to hear their position with regard to their support of that particular language. I have indicated to them that I have

discussed this issue with the Treasurer and the administration. We are going to take a look at the legal implications thereof and gather some more information, and then take it from there.

But at this point in time, neither bill-- This is not a Committee hearing scheduled to release a bill. It is just to take some input in terms of comment on the respective bills.

With that, unless you have something you want to add--

TREASURER CLYMER: Yes, thank you, Mr. Chairman.

If it is okay with you, I will leave Marge and Bob here to answer questions at the end of the presentations -- if that is your desire.

We have appreciated the opportunity to come here and address some of the concerns, and talk about the strength of the funds. It has been clear over the past couple of years that there has been a good deal of crying wolf, if you will, over the status of the funds and whether or not the sky is falling in. As you can see from the presentation, clearly it isn't. We have pension funds that are well above standard, that have enjoyed outstanding performance, and have been managed in an exemplary fashion.

We, as you indicated, have talked a little bit about some of the legislation, although we have not had the opportunity to really review the various packages. We will look forward to listening to comments that are made here today, and certainly addressing them in the future, considering anything that you would like us to.

I would point out that the legislation you have proposed does fully meet with all of the IRS concerns with regard to their recent examination of

our pension plan and its status, and does address those questions, I think at least from our perspective, adequately.

SENATOR INVERSO: Well, it was my intent, even though we do have another year-- It seems to me that we ought to tie in the agreement with the IRS as early as possible to assure everyone that State government going forward will not, once it has made a contribution to the system, be able to remove those funds. We all agree that that should not take place, and that the participants of the plans ought to have some degree of comfort to that effect.

The question about contractual property rights, and what have you, may be appropriate for, you know, a separate piece of legislation, or certainly separate debate and discussion going forward. But my legislation clearly intends to lock in, as you say, that agreement and put that to rest.

TREASURER CLYMER: We applaud your effort to do that promptly. We will do all we can to support that effort.

SENATOR INVERSO: Okay. Thank you.

With that, I will call the next speaker. Marge and Bob, I am sorry to keep you here a little longer.

May we have Jim Schroeder, Associate Director, Government Relations, New Jersey Education Association?

Senator Schluter had another commitment, so he had to leave. I guess it is a Committee of one. What control I have, at this point in time, right?

Jim, please go ahead.

JAMES E. SCHROEDER: Thank you.

First of all, I commend you for your willingness to persevere on such an exciting topic on a hot afternoon, but certainly it is an important topic.

SENATOR INVERSO: Well, Bob Baus thinks it is a very exciting topic. Right, Bob? (no response)

MR. SCHROEDER: Bob, and Peter, I think. That's about it.

Thank you for the opportunity to appear before you to discuss the status of the State's public pension systems and recently introduced bills to further enhance public employees' rights to actually receive the benefits they have worked for and been promised. With me today is Peter Christensen, who is Associate Director of Research and Economic Services for NJEA and a certified actuary.

The Treasurer and his actuary have repeatedly represented that changes made to the public employees' pension funds in 1994 will have no harmful effect on the financial integrity of the various pension systems. We wish we could be as comfortable as the Treasurer on this issue, but we cannot.

The TPAF annual report prepared by the State's actuary bears out our worst fears with regard to Chapter 62 P.L. 1994. That is, that the State's assumptions were far too optimistic. The fund has experienced substantial actuarial losses -- \$98 million for the valuation year April 1, 1994 to March 31, 1995 alone. Losses are attributable to inaccurate assumptions on the part of the State's actuaries for almost every assumption. Losses were generated through faulty assumptions on: active experience, retirees' experience, phased in mortality tables, increased membership, investment loss, and new retirees' COLA liability. Only on salary and COLA growth did the experience match the State's assumptions.

Cumulative losses under Chapter 62 have reached \$1.2 billion since the implementation of this law in the March 31, 1992 valuation. The initial pre-Chapter 62 reserve has shrunk to \$300 million -- down from \$1.5 billion -- and will shortly be exhausted.

The TPAF assets to liabilities ratio has steadily declined since the implementation of Chapter 62. This ratio should be at 100 percent in order to ensure that all plan participants will receive promised benefits. When Chapter 62 was implemented, the ratio was at 93.1 percent. Buck projected that over 20 years the ratio would rise to 100 percent in the year 2014. NJEA asserted that Buck's projections were too rosy and that, in fact, the ratio would decline each year until reaching the unhealthy ratio of 72 percent in 2014. After three years under Chapter 62, the ratio has declined by almost 7 percent and is now at 83.6 percent.

The 1995 report shows a disturbing demographic trend, inasmuch as 69 percent of the fund's active members -- 80,766 people -- are aged 42 or older. This is up from 68 percent and 79,727 people for the 1994 valuation year. As this aging population of teachers prepares for retirement, the fund needs to be shored up, rather than underfunded. My colleague, Peter Christensen, likens the phenomena of this group reaching retirement to the dynamic of a "hippopotamus getting into a rowboat." Unfortunately, the aforementioned \$1.5 billion which could have mitigated this dynamic has just about been exhausted in the last two State budgets.

The administration wants us to disregard the shortfunding, the demographic trends, and the disturbing data from their own fund valuation reports. They would have us believe that these problems are temporary. They

will self correct and, therefore, there is nothing to worry about. Well, we are worried, and we feel that the facts have shown that our anxieties are justified.

When Chapter 62 was passed, numerous legislators, who I believe were and continue to be of good intent, said that they would monitor Chapter 62. They told the public employees of this State that if things started to go off course, they would make adjustments to the law to keep our pension funds solvent for all current and future retirees. We believe the time has come to make those adjustments. Any changes we make now will protect not only public employees, but future taxpayers from the cumulative and compound effects of current underfunding of the retirement system.

First, it is inconceivable that the State does not match even the employees' level of contribution to the pension fund. The State should pay a minimum employer contribution of 5 percent of payroll to at least match what employees are contributing in TPAF and PERS.

Second, funding for COLA obligations should be accelerated.

Amortization payments should be leveled out.

The prefunding of postretirement medical coverage, which was discontinued and used up by the administration in Chapter 62, should be resumed even if it is only on a modest basis, at first.

Actuarial experience should be amortized over 20 years.

The pension funds should be returned to Entry Age Normal funding or, if maintained under the Projected Unit Credit system, the funding should be subject to ERISA standards.

Finally, two bills have been introduced to respond to directions from the Internal Revenue Service to the administration regarding the taking

of funds from the pension system. Both bills would incorporate the resolution of the State's IRS problems into changes in the pension statutes. We would urge you to embrace the more equitable of the two bills -- S-1132. We believe that S-1132 achieves the level of security that most public employees are entitled to and that Treasurer Clymer maintains they have. If the pension funds are as secure as the Treasurer and his actuary maintain, he should have no problem signing off on S-1132. This bill simply affirms that vested members of the various public retirement systems have a contractual property right to a secure and financially sound retirement system and the benefits provided by that system. It is also consistent with statutory protections afforded public employees in other states

The public employees of this State provide important public services to their fellow New Jerseyans day in, day out, year in and year out. They have been promised these benefits as part of a well-earned and well-deserved retirement. They are depending upon you to make the changes necessary to secure these promised benefits. We hope that you will respond accordingly.

Thank you again for the chance to present this testimony.

At this time, Senator, I would like to ask Peter Christensen to respond to some points that were made earlier.

SENATOR INVERSO: Before he does that -- Peter, excuse me -- Jim, on page 3 -- I made a note here -- other than the fact that you don't like my bill as much as you like the other bill--

MR. SCHROEDER: You are one of those well-intended legislators that I referenced. I should have mentioned you by name. I'm sorry.

SENATOR INVERSO: No, I don't need for you to do that, but I just wanted to make a point of the fact that you like S-1132 as opposed to my earlier introduced bill. What is my bill?

MR. SCHROEDER: It's S-1119.

SENATOR INVERSO: Yes, S-1119. My way of thinking is to conform to what the agreement is between the IRS and the State. It requires very simple language. I wanted to do it early to make sure that we got it in place -- to make sure that we had all of the protections in place.

The injection of the question of contractual property rights is an important issue, and I think we need to look at that going forward. I do think it is extraneous to the need to comply with the IRS pension agreement. That is all I will say about it at this point in time.

The question I have is-- Perhaps you can acquaint me with the-- "The funding should be subject to ERISA standards," as an alternative to changing the actuarial assumption method?

MR. SCHROEDER: I am going to defer to Peter on that one.

SENATOR INVERSO: Okay. I would like to know what those ERISA standards are, so that we can--

PETER CHRISTENSEN: Senator, ERISA standards simply define the operation of a funding method -- an actuarial funding method. It does it for the private sector. It has been worked on by the IRS for the 20 years that ERISA has been in effect. Essentially what they do is provide standards for reasonable and effective funding. So one of the things that go on in the State's use of the projected unit credit method that could not happen under ERISA would be, for example, not fully recognizing the COLA.

SENATOR INVERSO: Excuse me. I believe I will have Bob Baus kind of rebut that, at some point, through the Chair. But the unit credit method is an approach that ties in with the normal costs, right? COLA is not necessarily a component of that, or am I wrong?

MR. CHRISTENSEN: Oh, sure.

SENATOR INVERSO: It can be, or it is?

MR. CHRISTENSEN: Oh, it is.

SENATOR INVERSO: It is. Clearly it is. So you're saying that under a unit credit method, we should be recognizing both our normal service obligation, as well as the related COLA.

MR. CHRISTENSEN: Yes. According to the assumed rate of inflation.

SENATOR INVERSO: Okay.

MR. CHRISTENSEN: In other words, it relates directly to the benefits to be paid. Are you going to be paying a flood benefit of the individual's postretirement lifetime?

SENATOR INVERSO: Okay. I just wanted to make certain that I understood what you were saying. You are saying that COLA would be a funding component under the unit credit method of funding for our--

MR. CHRISTENSEN: Correct. There are some other benefits as well: the way the unfunded liability is amortized, the period over which the gains and losses are amortized. Essentially, it would be a more conservative funding approach than the State is now taking.

SENATOR INVERSO: We can always debate the question of conservative or nonconservative. I recognize that. I guess it depends upon

your vantage point as to what we have done with regard to actuarial changes if we made them less conservative or not. But government pensions are not under ERISA. So you are not suggesting that. But there are certain funding standards that ERISA requires of private sector companies that you think should be put into motion here from a governmental standpoint.

MR. CHRISTENSEN: I don't necessarily think that. That is a suggestion to make the plans' funding a little more tight and secure.

SENATOR INVERSO: Okay, fair enough. I just wanted to get a sense of what you were alluding to there. I mean, clearly we are not under ERISA, but on the other hand, probably with regard to the benefits that are accruing within the funds, you know, we could take a look at what ERISA provides for and see whether we are close or whether we are going in opposite directions from them. We don't want to be going in opposite directions, certainly, but--

MR. CHRISTENSEN: It might be an interesting thing to do, Senator. Even though you are not going to use the ERISA methodology for funding, it might be interesting to do a valuation on an ERISA basis at the same time you do your ordinary valuation just to see what the difference would be.

SENATOR INVERSO: All right. Peter, I sidetracked you from what I think you were going to say by asking this question.

MR. CHRISTENSEN: Oh, yes.

I guess I want to begin by thanking you for hearing me. I can't imagine what you have done, Senator, to deserve to have to listen to two actuaries in one afternoon.

SENATOR INVERSO: It is my retribution for being a CPA. I said this before, and I think Bob grimaced the last time. You know, what is an actuary? It is a CPA without personality. (laughter)

MR. CHRISTENSEN: Well, my mother wouldn't listen to this presentation.

But, in any case, I don't, as my colleague, Mr. Schroeder, suggested, want to directly rebut anything that Brian Clymer or Mr. Baus said. I simply want to provide, perhaps, a new perspective on this. That is, another actuary's perspective on why the funding of Chapter 62 is bothersome to me. I am not an old NJEA labor tiger. I have only worked there for 20 months, so, you know--

SENATOR INVERSO: That doesn't qualify you, the 20 months?

MR. CHRISTENSEN: No, I am not tenured until I am there three years. (laughter) And there is some doubt about whether I am going to make that.

MR. SCHROEDER: It is based upon your performance this afternoon. No, I'm just kidding.

MR. CHRISTENSEN: Anyway, as a fellow actuary, like Bob Baus, I look at this in an objective way, or I try to look at it in an objective way. I want to explain to the Committee in relatively simplified and brief terms exactly what bothers me about this plan. To do that, I have some charts.

SENATOR INVERSO: Let me reiterate, the hearing is not to revisit the appropriateness or inappropriateness of what we have in motion under the Reform Act. It is to determine, in my opinion, whether we are going along as was anticipated, and if there are any divergences, whether those

divergences are of such significance that when the next experience study is done there should be consideration given to making some alterations or modifications of those actuarial assumptions.

MR. CHRISTENSEN: Okay. Well, maybe this will not fit your standard, Senator, but it will touch on at least one of the issues you raised, and that is the-- You can see that we have professional high-tech level charts here. We have been outcharted by the administration, that's for sure.

My concern, essentially, has to do with the fact that 70 percent of the members of the TPAF are over the age of 42. That is 80,000 people over the age of 42. They are all within shouting distance of retirement. They can retire sometime between today and 18 years from today. My concern is that this will present an insupportable burden for the State financially if the Chapter 62 funding scheme is followed.

I have really done some simple numbers here. This is based on Bob's last report, which was dated March 31, 1995. But I just made the assumption that, to some extent, this does relate to the validity of some of the assumptions, or one of the assumptions, and that is retirement age. I have assumed that every teacher retires at age 57. Now, this is not an entirely probable thing. If you talk to any teacher -- and I talked to hundreds of them in making various presentations -- who is under the age of 55, that teacher will claim to be planning to retire at 55. It is just that simple.

I have assumed that they will retire at age 57. That produces, to me, a liability right now, or as of 1995, of \$25 billion should they all follow through and retire at age 57 -- this huge, bulge generation. We had, at that time, \$16.5 billion of assets on hand. This relates to, or produces an asset

shortfall -- what I am calling a "mortgage amount" -- of over \$8.5 billion. Very simply, taking that as a mortgage and amortizing it at the State interest rate over 30 years gives us \$800 million of annual payment. This is a flat amount. Two-hundred and fifty million dollars of that, I will represent, is paid by the employees. The remaining \$550 million is, however, the obligation of the State.

Let me just show you, Senator, how this compares to the anticipated, or projected contributions of the State -- and this is only for pensions, there is no postretirement medical in here -- that were made as part of the 1994 study. This is out of Buck's report. Now, of course, these numbers would change if people, in fact, started to retire at age 57. There would be substantial losses, but they would be phased in over a period of time, and there is a question as to whether the money would be going in fast enough under that basis. But you can see, I think, if you can see these numbers at all (referring to charts), the rather glaring difference between what is projected to go in and what could, under a very bad scenario, namely teachers retiring at age 57, be required to go in.

SENATOR INVERSO: Now, Peter -- excuse me -- you are presenting that just hypothetically, because that is a worst case situation which in the real world would probably never, ever materialize, that everyone would retire at age 57.

MR. CHRISTENSEN: Well, I think it is probably more likely than you are willing to give it credit for there.

SENATOR INVERSO: Okay. I mean, I know a lot of teachers and they still have kids in college at age 57 a lot of times.

MR. CHRISTENSEN: Well, I did this at age 62, anticipating your remark -- your criticism.

SENATOR INVERSO: Okay. All right.

MR. CHRISTENSEN: I had the same numbers worked up before, but they come out to a State mortgage amount here for 30 years of \$425 million if they stay to 60. Now that, I suggest, is even more of a problem. Again, the relationship between the projected Chapter 62 numbers and those using a retirement age of 60 are rather dramatically discrepant. The State does, at some point, hit the \$425 million, but it is way, way out here in year 2010.

Now, my story is almost over, and it is not all bad news. If we can get the teachers to follow Chancellor Bismarck's prescription that they work to age 65, we are in clover, just as we are if Roland can continue to earn 20 percent. I will stipulate that if Roland continues to earn 20 percent on the assets held in the State, we can all rest easy, there is no problem.

MR. MACHOLD: Done. (laughter)

MR. CHRISTENSEN: I would also like Roland to invest my own personal money at the same time.

If the teachers stick around to age 65, then we are, indeed, overfunding the plan. That is only a \$125 million mortgage payment, as I have worked out here for the State, and the State is plainly putting in, according to the Buck projections, much more than that. In fact, again, if this actually happened, this pattern of retirement, these numbers would shrink, because there would be actuarial gains.

While my difference with Bob Baus is, I don't think, quite so dramatic as perhaps might be suggested by the fact that we are on different

sides of the legal fence right now -- we are in litigation -- I think a pension plan is a thing that is at risk. The question is: How much risk is involved in any given funding approach? I think Bob Baus thinks that he can talk for himself, but there is an acceptable range. I think Bob thinks that it falls within the acceptable range. I would guess that he thinks it is toward the risky side of that acceptable range -- I will let him talk for himself -- where I, on the other hand, think that the Chapter 62 funding methodology, like "Thelma and Louise," has gone over the cliff, over the edge of the reasonable, acceptable range of funding. There is too much risk involved. The numbers I have shown here, Senator, are numbers which would really be, I think, unsustainable with the taxpayers of the State of New Jersey, if this sort of retirement experience were to emerge and they were to be called upon to make good those benefits by amortizing losses to the system.

That is pretty much my presentation. I thank you very much.

SENATOR INVERSO: Thank you.

Well, I guess, Bob, I will have to turn to you. Can you respond as to the reasonableness-- Or do you need more time, Bob?

MR. BAUS: I can't hear you, Senator.

SENATOR INVERSO: Oh, my microphone is not on. I'm sorry.

Do you want to respond to the reasonableness of this hypothetical situation?

Peter, could you please hand Bob that microphone?

MR. CHRISTENSEN: Oh, sure.

MR. BAUS: We do not do our studies based on extremes. What we do is take a look at the experience of the system and we do our studies

based on the experience of the system. The fact of the matter is, your retiree population is between 61 and 62 on average, and it has been for years. So we are in here somewhere, and we are very happy to be here. I mean, this should not be a concern at all. This is pure speculation that the average age is going to go down. In fact, that would be an incredibly dramatic experience to see that kind of an event happen in any kind of a short term, when historically -- and I mean long-term historically -- you fall in here.

So I think I have to agree with Peter. I have no problem with any of this. I just don't believe that. I believe that what we did, which puts us in here (demonstrates), is closer to what reality is going to be, so we are very comfortable with the results.

MR. CHRISTENSEN: See, I told you we were a lot closer than people thought.

I will say this, in response to what Bob said: I think we are in unusual, different, and transitional economic and social times. I think we would be very much mistaken to assume that things are going to happen in the next 20 years the way they happened in the last 50, or the last 20. It is a function of a lot of things, and I am sure you are all as well versed in this as I, but certainly the demographic bulge, the age distribution and balance in America is a major factor. Health insurance is a major factor. Employment relations between employers and employees are in radical change -- transformation.

I just think that is the kind of thing that somebody needs to worry about.

SENATOR INVERSO: Peter, I mean, in all fairness, what you are looking at is something that is, perhaps, prospective.

MR. CHRISTENSEN: Yes, absolutely.

SENATOR INVERSO: You are saying that society has changed. On the other hand, people are having children later in life and, therefore, their obligations for education go a lot later. What actuaries generally look at are the historic trends and try to project those out.

So, while you may be presenting a case that going forward could materialize, that is more highly speculative than, in my opinion, what has occurred and then would be projected out. Yes, it would alarm me if we had a \$550 million annual obligation for the unfunded portion that exists right now for those individuals. We would never, ever get to a point where we were actually paying for it on an annual basis. But if I am between 60 and 65 -- as Bob suggests that historic patterns support -- you, as an actuary, are you comfortable with the funding that is incorporated in the system?

MR. CHRISTENSEN: Well, no, not entirely.

SENATOR INVERSO: I didn't expect you to be.

MR. CHRISTENSEN: The reason these numbers work out so well for Bob is that I am using all of his assumption and all of his numbers, so that in here--

SENATOR INVERSO: You might change some other things, mightn't you?

MR. CHRISTENSEN: Yes.

In here there is implicit a-- It should work out. Quite frankly, if it didn't work out that age 62 produced a funding pattern that was in

accordance with what Bob projected, there would be something wrong with my numbers, because I am using his assumptions and his methodology.

SENATOR INVERSO: Okay, all right. So the point of your presentation is that if we were all -- if all the teachers were to retire at age 57, we would have a major shortfall problem that we would have to contend with.

MR. CHRISTENSEN: Or age 60, for that matter.

SENATOR INVERSO: But there is no historical, no empirical experience right now to support that hypothetical?

MR. CHRISTENSEN: No. We call that, in the actuarial business, driving the car by looking in the rearview mirror.

SENATOR INVERSO: Yes, okay. All right.

But whose speculation about the future is to be accepted as the basis for reaching a decision of this kind of magnitude?

MR. CHRISTENSEN: Well, you can listen to whomever you want, Senator. I am giving you why I am concerned.

SENATOR INVERSO: Peter, I am not arguing with you. I am just trying to be objective here. I mean, you know, I am 57 now. I wish I could have retired two years ago. I couldn't. I just don't know whether 57 is a reasonable retirement age.

Sure, in a sense, we are all imbued with the media, television, whatever you will, R&R, and, you know, you have to enjoy yourself and relax in life, everybody wants to retire younger and younger, but I don't know. With the cost of living being what it is, with people having children later in life, I just don't know if we are not going to see people retiring later on. Then,

of course, what happens at the Federal level with regard to Social Security and with regard to health.

There are a number of factors. I would think that an earlier retirement age is less likely than a later retirement age. Now, there are examples that could refute what I say. People do get out at 55 the first opportunity they get. But I don't know if that is the bulk or not. We could debate this all day.

MR. CHRISTENSEN: I think you and I have equal grounds -- equal expertise in this area.

SENATOR INVERSO: No, probably you have more, I'm sure.

MR. CHRISTENSEN: No, I mean in terms of when people who are now in their 40s and early 50s are going to retire. Your guess, I would say, is as good as mine.

I will just say two things: The TPAF is set up to reward earlier retirement, both with respect to pension benefits, but also with respect to health benefits.

Number two, you just have to talk to teachers. It is a demanding job. It is an unchanging job. It is not nearly as congenial a job, I don't think, Senator, as yours or mine.

SENATOR INVERSO: Don't bet on it, Peter. Don't put me in your category.

MR. CHRISTENSEN: Well, certainly--

SENATOR INVERSO: I will put the stress of my job, outside the halls of this building, on a par with anyone. Trust me. Jim knows. He has tried to reach me at different times during the year. So, I mean, you know,

let's not get into comparisons, because I don't think a lot of people would like to exchange the stresses in my life for what they have in theirs. Trust me.

MR. CHRISTENSEN: In regard to the stress, then you bear it--

SENATOR INVERSO: Strike that from the record. There is no need to have my personal problems -- pressures on the record, but I did say that.

MR. CHRISTENSEN: You bear that stress, Senator, with a great deal more equanimity than do the teachers, who are--

SENATOR INVERSO: You said that, not me.

MR. CHRISTENSEN: You simply have to put the word "pension" next to the word "workshop" to get 250 teachers crowded into a cafeteria to listen to you talk. They are all looking to get out, as I say. If they are under 55, they are talking 55. There is almost nobody who is already over 60 who-- As a matter of fact, I have done this Chancellor Bismarck business before. I say, "Listen, all you guys have to do-- The pension problem with the State will go away if you people simply suck it up and work longer. Work until 65." They hoot and holler, and my life is imperiled at that point.

SENATOR INVERSO: Well, I will give you an "A" for trying, Peter, with that group.

I think Marge McMahan had a comment she wanted to make. Marge, will you please come forward?

MS. McMAHON: First of all, I hope you are all enjoying the duel of the actuaries. I know I am.

But I think there is one thing, as we all deliberate and worry about the pension and the participants -- and Bob and Peter will attest to this-- Peter

is saying that things are going to be different. The next 20 years will play out differently, and he may be right. But the pension systems are looked at every year. We are not going to fall off a cliff in 20 years. If everybody starts to retire earlier, we will make adjustments. So the valuation takes place every year. An in-depth experience study takes place every three years. No matter who is right or wrong, the future will tell. Adjustments are made all the time.

You talked about Bismarck and his prediction that people would retire at 65. Well, I think all of those notions have to be examined, because he made the retirement age 65 when people were only living until 47. So he didn't have very much payout at all, but I wouldn't recommend that kind of a plan.

I don't think there is anything to be alarmed about when these studies go on annually.

SENATOR INVERSO: Okay. Thank you.

Is that it, Jim?

MR. SCHROEDER: Yes.

SENATOR INVERSO: Peter?

MR. CHRISTENSEN: Yes.

SENATOR INVERSO: Thank you for coming forward with your presentation.

Next will have John Loos, CWA. John?

JOHN LOOS: Thank you, Mr. Chairman. This is the first time I have addressed a Committee of one.

SENATOR INVERSO: I don't know whether it is my leadership or the subject matter. I am not quite sure.

MR. LOOS: I do feel that there should be banjos playing in the background as the dueling actuaries face off.

I guess, over the last couple of hours, people have talked about actuarial assumptions. People have talked about rather technical matters. From the perspective of our members, they want actuaries to duel. They want people to worry about how the system gets funded. But their primary concern is that their benefits are going to be there, the benefits they think they earned; that the State will meet its obligation to pay out those benefits.

I guess the concern we have-- Looking at the TPAF chart that the NJEA put up, you see that the contribution of the State rises dramatically between 1995 and the year 2014. It is projected there under Buck's study that nearly an eightfold increase is going to take place. That leads us to worry that some future Legislature, when they have to find, instead of \$50 million to put into that fund, they have to find \$450 million or \$470 million, that they are going to say, "We can't do it." That leads, then, to some future Legislature potentially saying, "Let's cut the benefits." That is a problem.

Somebody works 23 years, thinks he or she is going to retire in two years, think they have 23 sixtieths of their salary that they are going to go out with, and then suddenly some future Legislature says, "We are not going to put \$450 million into this fund. We are going to change the benefit level. We are only going to give you, instead of 1 sixtieth, 1 120th. That is a problem. That is why we think it is critical that this Legislature guarantee the benefits that employees have earned.

Having said that, it is the advice I get from our attorneys that the way to do that is to declare, in State legislation, that employees have a

contractual entitlement to the benefits they have earned, and that those benefits cannot be impaired.

The legal theory on this is that the Federal Constitution states that -- and I am paraphrasing here, because I have not looked at it recently-- It basically states that the states of the United States cannot pass laws that impair the obligations of contracts. In order for an employee to have the security, the State has to create this contractual relationship. It is not a labor relations contract. It is a contract between the people of the State and the people who work for the State, or any of its subdivisions.

That is what we ask you to look at. Let's get all the attorneys together on this matter. Get them in one room and let's see how we can secure benefits. That is the first thing.

SENATOR INVERSO: Let me say, in response to that, that clearly I feel strongly that the same protections and rights that are accorded, say, under an ERISA standard to people in the private sector, should be accorded to people in the public sector, the governmental sector; that once they have their pensions established as at a point in time with regard to vesting it, that you cannot go back retroactively and change what has been earned, what has been accrued, what has been vested in.

I think ERISA provides for that. Surely, at a minimum, that is what we should provide here, too.

MR. LOOS: That's right.

SENATOR INVERSO: As you and I discussed on Friday, we will look at the aspect of the specific language and the legal import of that relative to the State pension systems going forward. I have committed myself to

working with you, with the NJEA, and with others to get us to a point where there is the same equity provided toward the security of an individual and his or her pension system that the private sector has provided through the ERISA requirements. The governmental side will have to do this through legislation.

Hopefully, we will work through some reasonable and amicable resolution of that. I have already spoken to the administration. They are willing to sit down and chat. There is a point beyond which they will not go, certainly, but that is what we have to do. That is the job we have ahead of us, to see where we can get mutuality in terms of this issue.

MR. LOOS: Okay, good.

The second matter that I think the Legislature should take a look at is the issue of an independent actuary. I mean, what you saw here today, the performance between the union actuary and the State's actuary, puts you in the position, as legislators who have to figure out how much money to put into this fund on an annualized basis, of who to believe.

Our recommendation is that the boards of these various systems be permitted to hire their own actuaries. It is my recollection that, in the early 1980s, the Legislature did put such legislation on Governor Florio's desk, and he conditionally vetoed that as part of the--

SENATOR INVERSO: That was in the early 1990s.

MR. LOOS: Yes, what did I say?

SENATOR INVERSO: You said, "in the early 1980s."

MR. LOOS: Yes, the early 1990s, right.

SENATOR INVERSO: You're right. I think as part of that Pension Reevaluation Act, some of that governance change to the pension

systems was put in the bill that went back to the Governor, and he struck it out.

MR. LOOS: Right.

That doesn't resolve the issue of how much money will go into the fund, but it certainly gives this Legislature some sense of whether or not either the unions or the administration are driving their numbers out of political considerations, as opposed to out of actuarial assumptions.

The last thing I think this Legislature should consider -- there has been a lot of talk about ERISA -- and that is lowering the vesting age from ten years to five years. In the private sector, employees vest after five years. Certainly, nowadays--

SENATOR INVERSO: I know where you're going.

MR. LOOS: Okay. Certainly, nowadays the projections are that people will hold many jobs over the course of a lifetime. I have heard as many as eight or ten jobs over the course of a lifetime. I think what we have now, by requiring ten years vesting, is-- Potentially you have employees who get seven or eight years in State government, decide that, "Gee, maybe this isn't what I really like to do," but they would like to move on to someplace else, but feel they are so committed in terms of number of years, that they stay until they get their ten years in. We should be looking toward encouraging some employees to move on, if that is what they want to do. The way to do that, I believe, is to bring the vesting down.

SENATOR INVERSO: John, I was going to ask Jim Schroeder this earlier, but I failed to. Since you elaborated more on the contractual

property language, what do you feel about New York's tiered system as a result of having language like that?

MR. LOOS: We would oppose tiers. The unions in New York State oppose tiers, but the legislature ended up, at some point, going with tiers.

SENATOR INVERSO: Do you think you can have it both ways? I mean, what I am suggesting is, you can have this language that you are after with its legal import, which we can agree on, and not have tiers. You see, that is what New York did. New York responded to tiers. You don't like tiers, so how do you--

MR. LOOS: Well, I would also say that in a system that is currently being funded 73 percent by the employees, that it would be pretty outrageous for the Legislature or the administration to start talking about cutting benefits, when they are hardly stepping up to the plate to pay for any benefits.

SENATOR INVERSO: First of all, John, no one is talking about cutting benefits.

MR. LOOS: No, I know that, but in terms of tiers--

SENATOR INVERSO: In terms of tiers-- But that starts with new employees. Those tiers are for new employees, are they not?

MR. LOOS: In New York State, that's right. They are for new employees.

SENATOR INVERSO: Okay. I just wondered what your reaction to that would be.

Jim, you nodded your head, so you have the same reaction?

MR. SCHROEDER: (speaking from audience) I am not enamored with tiers. That would work side by side with different levels. (remainder of comment indiscernible; no microphone)

SENATOR INVERSO: Okay.

Thank you, John. I appreciate your input.

Next we will have Charles Goldstein, AFSCME.

CHARLES GOLDSTEIN: Mr. Chairman, when the most recent changes occurred, you reassured all of us that you would continue to monitor this. The first thing I want to do is thank you for doing that.

This is not an issue that can be ignored. It is difficult and it is annoying to reiterate what has been indicated, but one of the primary problems is the dueling actuaries. I would echo that there is clearly a need, as demonstrated by what occurred today -- by the presentations today and what has occurred with OLS' evaluations and other evaluations occurring during the various pension revisions. There is an absolute need for independent evaluation to make sure that at least there is one evaluation out there where at least there can be no implication that it is being driven by anything but actuarial analysis.

The second point is with regard to the property right. We consider that an absolute essential. I think you're right putting that in your comparison with what goes on in the private sector. We think it is absolutely essential, particularly in light of what has occurred with the increased reliance on direct employee funding of the pension system.

In light of the extensive testimony that has been presented in those and other areas, we would simply indicate that with regard to TPAF, PERS,

and the other systems that are involved that we do not want to wait 5 years, 10 years, 20 years until we have a massive reevaluation and a massive reinfusion of funds-- We do not want to wait for that type of a crisis, which we believe is quite possible and probable under the present structure. We think, again, that there has to be a reevaluation, only this time the reevaluation has to be done in such a way not to balance a budget, but to ensure that the pension funds of the employees are protected.

SENATOR INVERSO: Since there is no one here to raise a question with you, and I do not have a question, thank you, Charlie. I appreciate it.

MR. GOLDSTEIN: Thank you.

SENATOR INVERSO: Again, there will be an experience valuation -- a three-year valuation -- done, as was indicated earlier by Bob Baus. Now, what that will do, of course, presumably-- I guess I shouldn't prognosticate, but presumably what it will do is, it will look at the performance of the systems relative to the actuarial assumptions that we have put into place, and will make adjustments to average out the variations that arise from what was planned. But -- and, Bob, correct me if I am wrong -- it won't necessarily look at whether we should go back to an entry age normal method. It will just be a matter of going forward, unless there is a policy decision made to make a change.

Am I correct in that kind of description, Bob?

MR. BAUS: Yes, Mr. Chairman. We are going to be looking at the assumptions that we use to do the valuations, but, I mean, I have to be

honest with you, based on what has happened so far since reform, there is no basis for making any change, as far as I can see.

SENATOR INVERSO: What you are saying is that the actual results of the last couple have been pretty much on target with what you had anticipated. The \$98 million loss in the teachers' fund resulted, primarily, from the bad investment experience. We lost about half -- about half, right? -- of our credit that had been developed as a result of the actuarial changes.

MR. BAUS: Correct.

SENATOR INVERSO: We went from that bad year to Roland's masterpiece. Now no one anticipates, despite Roland's assurances earlier, that we are going to be at 20 percent a year. I mean, that would be utopian, and we are not going to be there. You will measure whether or not the ensuing interest years show more closely to the 8.75 percent. If we are not, you will make an adjustment, presumably, as well as the salary component. So that spread we talked about has to be maintained.

I just want to let John, Chuck, and so on, know that unless there is a policy initiative with regard to the actuarial methodologies, don't expect that there will be a methodology change as a result of the experience valuation. It will just be a matter of how we smooth out the rough spots on the minus side and how we advertise the games on the plus side.

We are coming down now to 30 years-- Where are we now, 36 years, 37 years? (indiscernible response from unidentified person) We are coming down now to 37 years in terms of the amortization, going to a 30-year amortization. When I look at this chart here, Bob, quite honestly, it is just a question of whether you bought into the unit credit method as part of the

Reform Act or not. I mean, clearly it is an actuarially sound method, or actuaries would not be using it.

Now, is it as conservative or not conservative when compared to the entry age normal method? I mean, that debate could go on as it went on a couple of years ago. It is a method-- As an accountant, I would rather see something that is level. This does not have that effect. It has that curve effect. But it is an actuarially good method. I would like to see a couple of years under our belt in terms of whether there has been major divergence from that in terms of the experience, right, the composition of the workforce, and all the other variables that enter into it.

I don't know at what point you say, "Well, we have gone too far afield with regard to our method with regard to actual experience." But two years is not a sufficiently long period to make that kind of a determination, and three years isn't. Now, we will continue to monitor this thing. I don't know whether six years, or the next experience valuation -- whether those who are here at the time will take a look and say, "Well, wait a minute. You know, this thing isn't working out as we expected it to for reasons that are unique and peculiar to one of the systems within the total pensions systems.

MR. LOOS: Pete, one other question.

SENATOR INVERSO: Come up here, John.

MR. LOOS: To me, the biggest policy issue that comes out of (indiscernible) is the fact that this is so taxpayer unfriendly, because what it does is require the taxpayers of this State to foot the bill for the pensions, instead of putting money in at an earlier date and allowing the stock market, etc., to fund these systems. By waiting until 2010 to put \$450 million in

there, what is really going on is that you don't have the investment income of that steady state there. So this is the most taxpayer unfriendly kind of funding system. Sure, it is friendly in the years 1995, 1996, 1997, and 1998 to those of us who vote in this election, or the next, or the next, but we are all going to be around out there in those years, or at least the overwhelming majority of us are, and we are going to have to pay for it out there.

SENATOR INVERSO: Bob, can you respond?

MR. BAUS: That presumes that there is a fundamental error in the assumptions that are being made. What that chart is really telling you is, this is exactly where we ought to be, presuming that the past experience of the system is reflective of what is going to happen in the future.

Peter said the same thing. I mean, if we stay at 61 or 62 as the retirement age--

SENATOR INVERSO: You will be on target.

MR. BAUS: --this is an ideal contribution pattern for the taxpayers and for the participants. You know, there is a fundamental issue whether you buy into using the experience to set the assumptions.

SENATOR INVERSO: Right, that is the issue, whether you buy into that or not.

MR. BAUS: As far as the methodology is concerned, I mean, I have to be honest with you. The methodology is not driving the funding of this system. What is driving the funding of this system is the phasing in of the COLA. That is where the sensitivity of the cost is going to come in.

SENATOR INVERSO: Is that where it is? So it is not the methodology.

MR. BAUS: That is my own view.

SENATOR INVERSO: I appreciate that, but when you look at the methodology and you see the increase in the out years -- all right? -- when you look at that, you say, "Gee, politically the perception is that we are pushing that cost out." John just alluded to that. He said, "The early years, it is good for the people who vote today, because the cost is less, but look at what we are pushing out."

Respond to that. I want you to. I want the response.

MR. BAUS: Yes, but what you have to recognize is, the dollars are not the issue here. The question from a taxpayer equity standpoint is: What percentage of pay does the system cost? If I say the cost of the system, in the long run, is going to be 6 percent, the ideal, from a taxpayer standpoint, is to see a 6 percent contribution every year. Well, the fact of the matter is, as you go out over those 10, 15, or 20 years, the payroll basis is going up dramatically, and as a percentage of pay -- and our Study showed this -- although the dollars are increasing, as percentage of pay they are staying much more level than under the entry age method. That is the fundamental reason for the change.

SENATOR INVERSO: Do you understand that?

MR. LOOS: Yes, I do.

SENATOR INVERSO: You don't accept it, perhaps, but he's right, though. If the percentage does normalize at 6 percent and you see that growth, it means that the base is growing, and the base is only growing if you have more people and are getting more pay.

Now, one could argue about the projections, but the projections-- The wage factor that is used in the projection is-- What is 2.8 percent from 8.75 percent? It is about, what, 6 percent? Right?

MR. BAUS: Yes, and the population was not projected to grow.

SENATOR INVERSO: The population was very static, so you got 6 percent pay. When you start compounding that over those years, it gives you a big number.

Now, that's interesting. I appreciate that, Bob.

It's a shame I don't have any other Committee members here. I could say, "Well, let me turn to them," so I could catch up with myself here. Could you just bear with me for a second, please?

Bob, could you please come forward again?

I think I may have asked this earlier, but if not, let me ask it now. Just let me read my notes here. Projections that you provided in 1994 were based on the ABO methodology. Is that correct?

MR. BAUS: No, no, no. No, the forecasting study done in 1994 was based on PBO funded levels.

SENATOR INVERSO: Oh, PBO.

MR. BAUS: The study we did back in 1989 was based on ABO.

SENATOR INVERSO: Okay. So 1994 was PBO.

MR. BAUS: Correct.

SENATOR INVERSO: I guess in order to try to compare apples and apples in this difficult topic area, could you provide me with a, I guess, comparative analysis of the 1994 projections using the PBO, which I guess is what you have in your actuarial report now, this table on page 14?

MR. BAUS: Yes. The problem with the numbers in the actuarial report is that they use the valuation assets, not market value assets.

SENATOR INVERSO: I would like to get a PBO/ABO comparison on the same basis.

MR. BAUS: Yes, it is right here.

SENATOR INVERSO: You are going to give it to me now, okay.

Staff is whispering in my ear, saying, "Go back to the basis that existed in 1994," the point at which we made the change.

If there is any question about what we want, I will talk to you after the hearing and we will try to get that information.

MR. BAUS: What you essentially want is something to compare to the forecasting study on the same basis, yes.

SENATOR INVERSO: Yes, exactly.

MR. BAUS: I got it.

SENATOR INVERSO: Is there anyone else who hasn't registered to speak who would like to say something at this point in time? Would anyone care to make any statement at all about any point? No? Are you all thoroughly confused? (no response)

I want to thank you for coming out today. As I said earlier, this is part of the oversight that this Committee has to provide over the pension systems. Obviously, we are not going to make changes as a result of what we have heard today, but what we got today -- we got a point for commonality with regard to measuring what was projected to be and what we do have. We will look at the experience rating that will be done for the three-year period. So long as I am here, and this Committee is here, we will continue to look at

whether or not it is appropriate to rest with what we have, or whether it is probably more appropriate to start providing some input into the administration with regard to, perhaps, changes of some of the assumptions. But that would only be based upon having at least six years under the belt, because you just don't make changes overnight. Whether you accept or do not accept the reform changes that were done two years ago, once you have those changes to start whipsawing, changes back and forth, I don't think that is sound, nor is it actuarially the right approach to take.

But it is important for us to come to this point and review whether they were on target with regard to what they projected. If they were on target, that would provide me with some degree of comfort. If they are way off target, even knowing that they have an opportunity to level out the impacts because of the method of amortizing gains and losses that occur for investment reasons, for changes in employee mix, and that type of thing, you know, if they are way off base, then a couple of years from now we will take a look at it again.

We will continue to monitor it. We want you to know that this Committee is also available. Rather than play these things out outside of the halls here, if there is a need to bring the pension people in together to discuss an issue that concerns you, let us know. We will use this Committee to facilitate that, to work with you, the unions, as well as with the administration in getting all of these things out into the public, so that we can understand that we all should be working together. We should not be working at odds with each other. We all have a stake in this, whether you are on the management side or the employee side as a participant. It is important that these things all kind of come together in a way that we understand. There should be

uniformity and there should be mutuality on how we do things. We should not be tugging at each other.

I know we have a major issue with regard to the contractual property rights issue. I have certainly made a commitment to myself to pursue that area with the administration, and I will work with the unions -- Jim, John, Chuck, and whoever else wants to be part of that. We will work with you.

I don't think there is any argument with regard to the administration in terms of what an employee has a right to through his vesting and through the attribution of benefits at that point in time. I don't think anybody wants to change that. So if there is where we need to be, I don't think we are going to have much of a problem, you know, in terms of what you do going forward, so long as going forward doesn't impact, or affect negatively what you have a right to in terms of what you have vested at that point in time. I think we're okay. I don't think the administration -- this administration or any administration -- would ever want to take back from someone what they have vested and have a right to. That does not mean that the administration should not have the prerogative of making a change in going forward. I mean, that is a prerogative that any management or any administration should always have.

So somewhere we have to bring each other together to lock in what we want to lock in, without tying anyone's hands in going forward, so long as doing that does not impact what someone has locked in. I mean, if we are there -- in just my brief discussions with some of the union people -- that is where you want to be. If I have misinterpreted what I have heard in

conversation, please let me know later, but that is the goal that I am going to work toward.

We have a sanctity, if you will, to the rights and the benefits that the person has locked in under the pension system as it exists today. We cannot retroactively go back and change that, undo that. But that does not necessarily mean that prospectively, at some point, there could not be changes that might alter what terms exist today, so long as there is no vesting or right in those terms today. I guess that is where we have to kind of resolve it.

John, that is where we are, right?

MR. LOOS: That's right.

SENATOR INVERSO: Jim, do you think that is where we are?

(no response)

It goes without saying that no one is suggesting a change at this point in time. This topic comes up because of the insertion of that language in the bill -- is it 1132? (indiscernible response from aide) No, mine is 19, so, yes, 1132. Never have I had anyone say to me, "We are planning to make a change going forward."

With that, is there anything else to be said? (no response)

I want to thank you. It has been a long hearing, almost three and a half hours. I appreciate everyone's input.

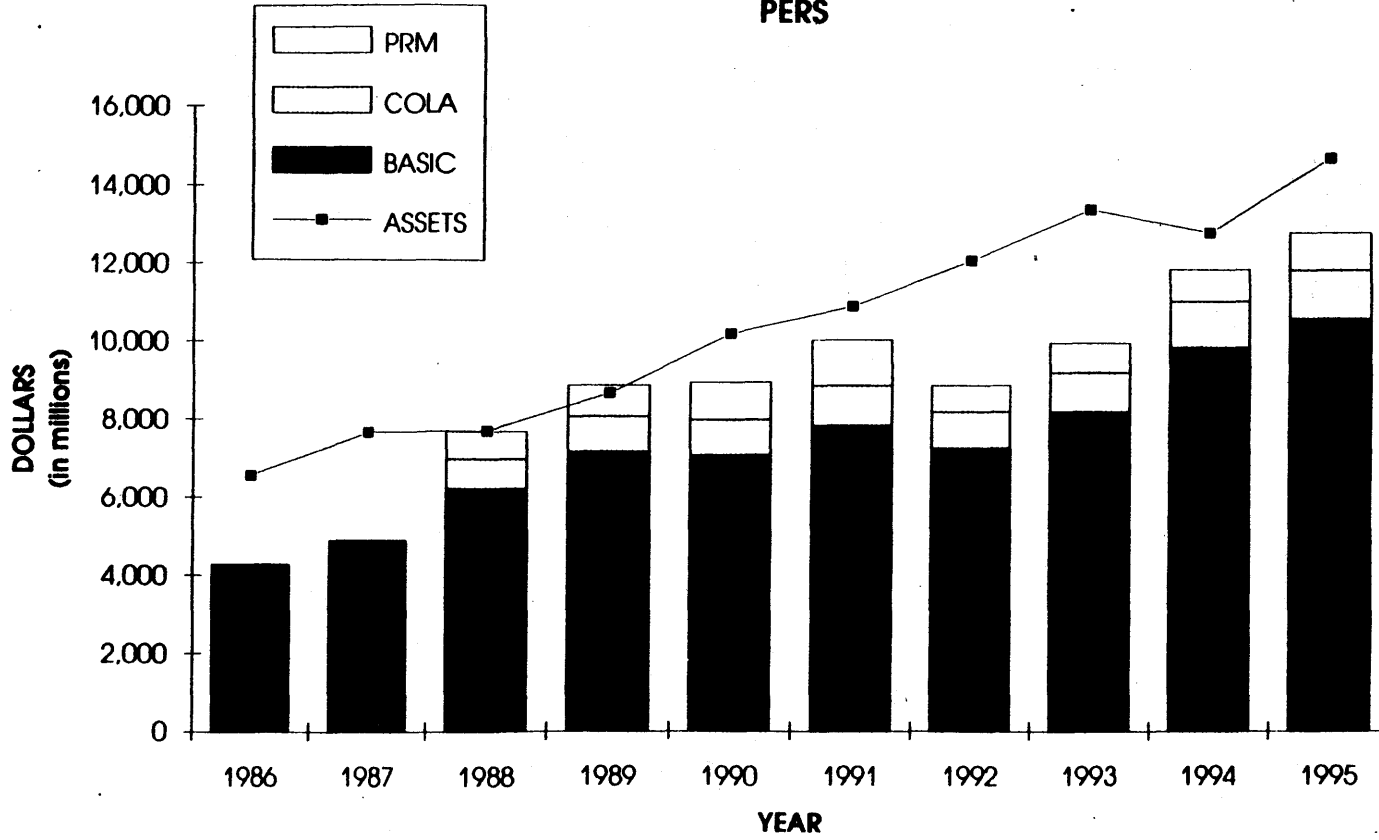
Thank you.

(HEARING CONCLUDED)

APPENDIX

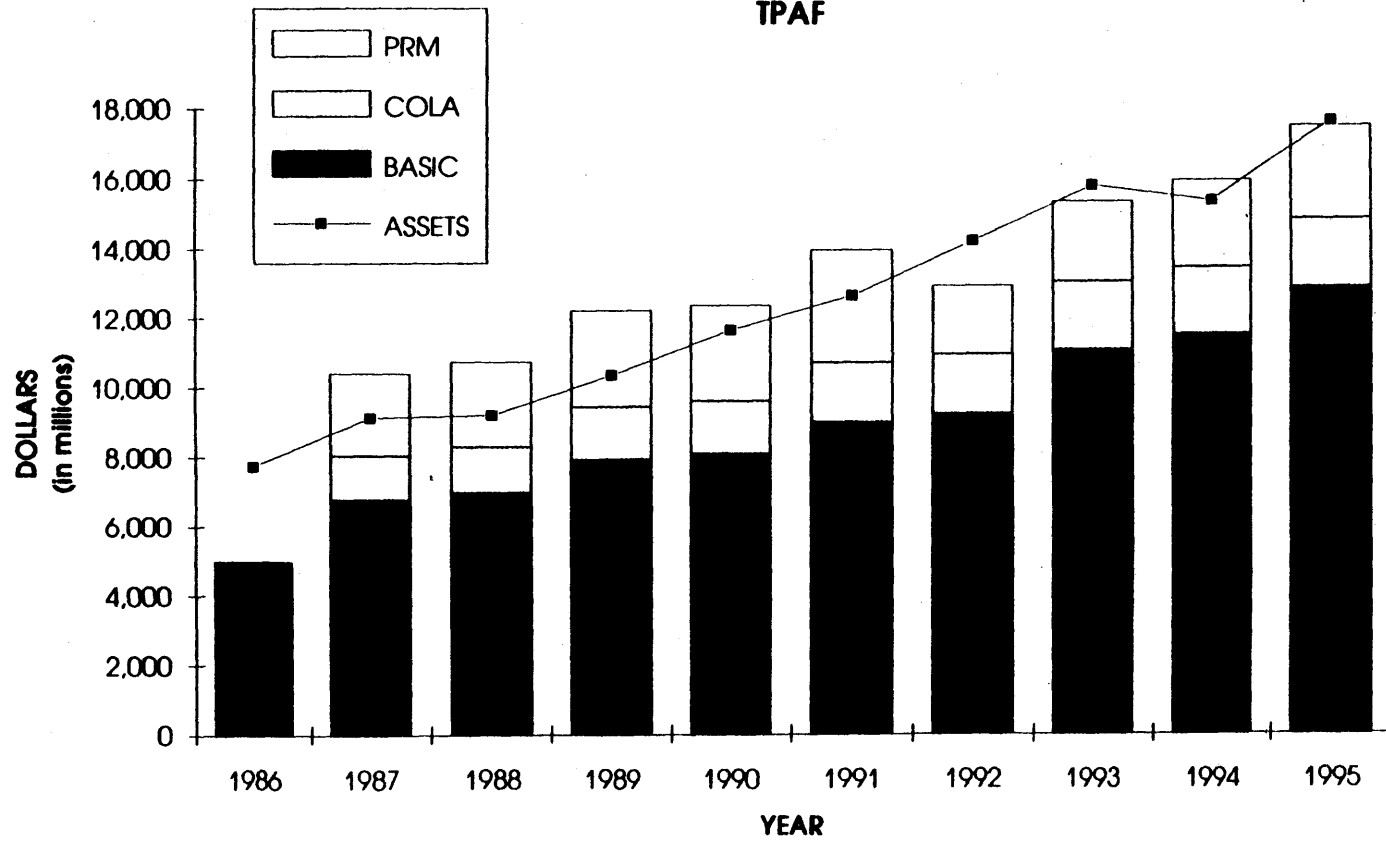
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ASSETS AND LIABILITIES PERS

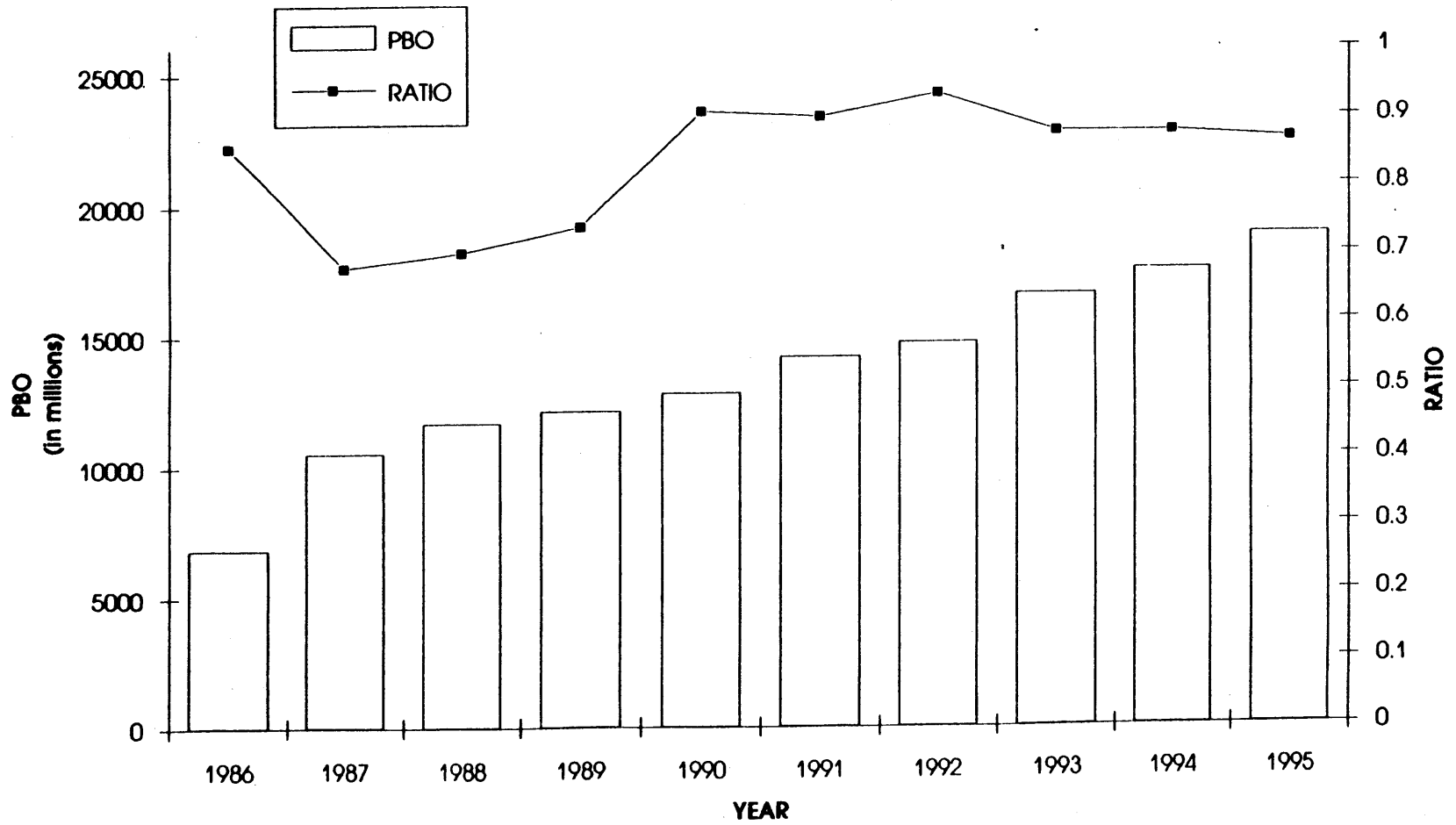


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ASSETS AND LIABILITIES TPAF

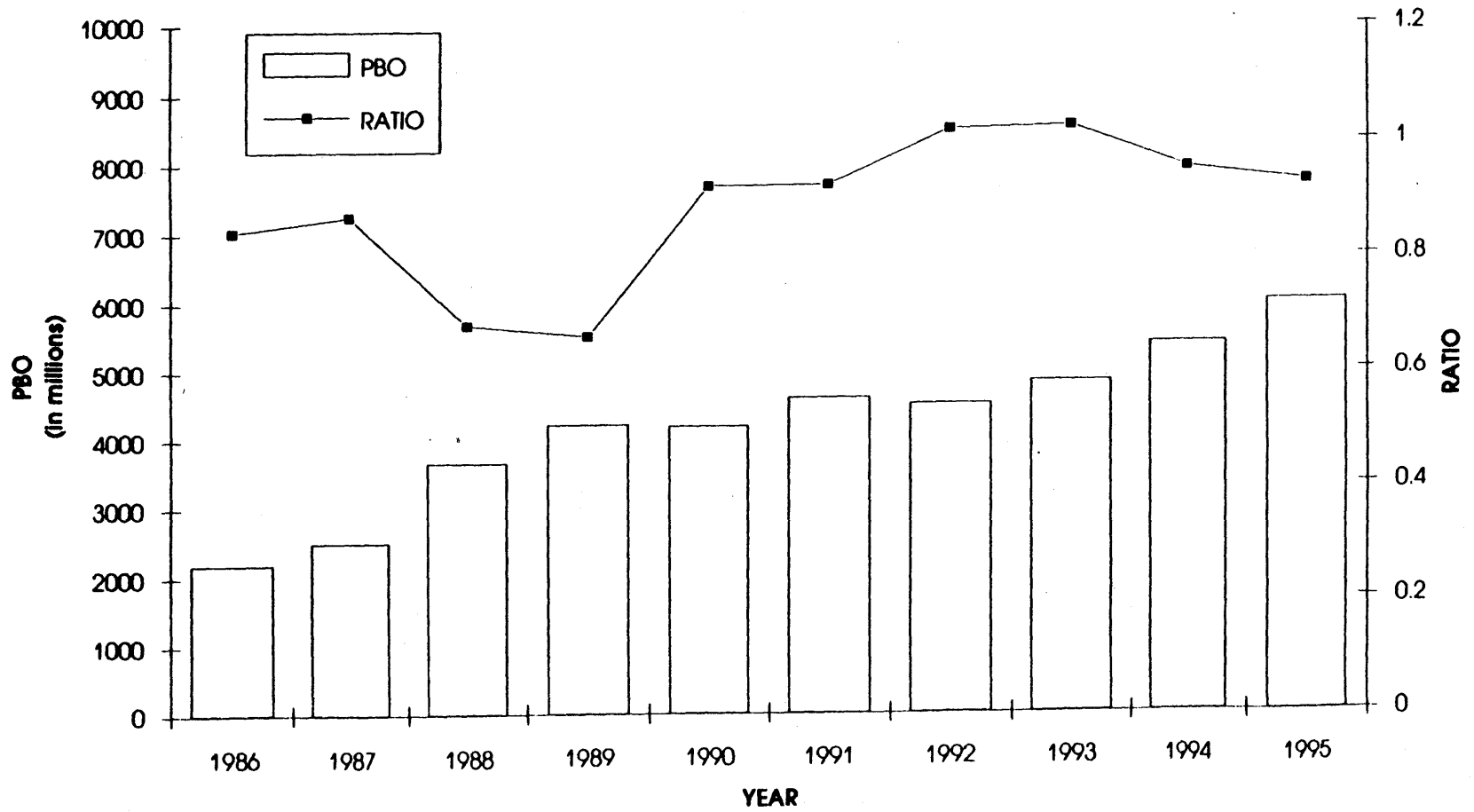


PENSION BENEFIT OBLIGATION (PBO) AND FUNDED RATIO TPAF



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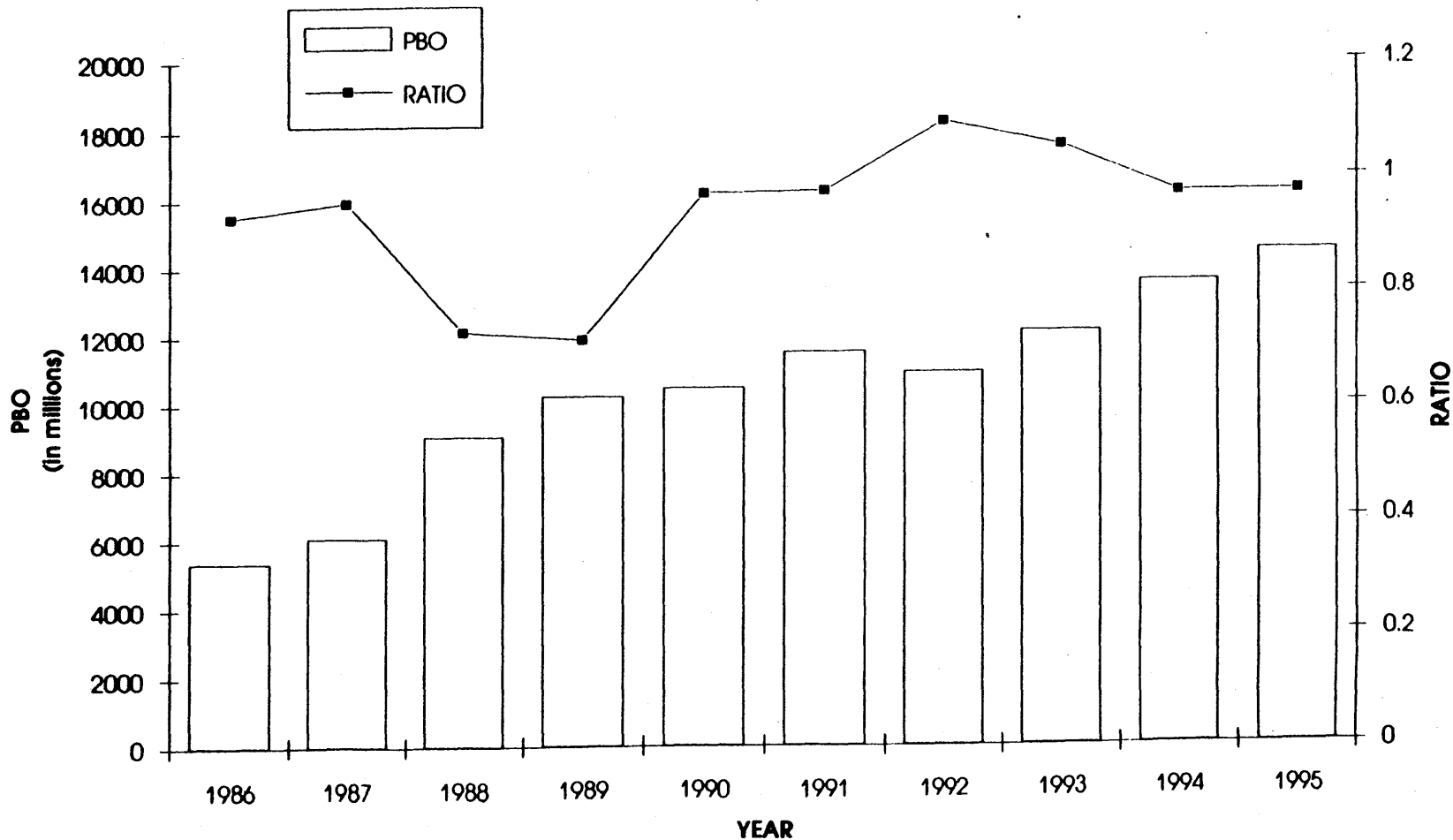
**PENSION BENEFIT OBLIGATION (PBO) AND FUNDED RATIO
PERS-State**



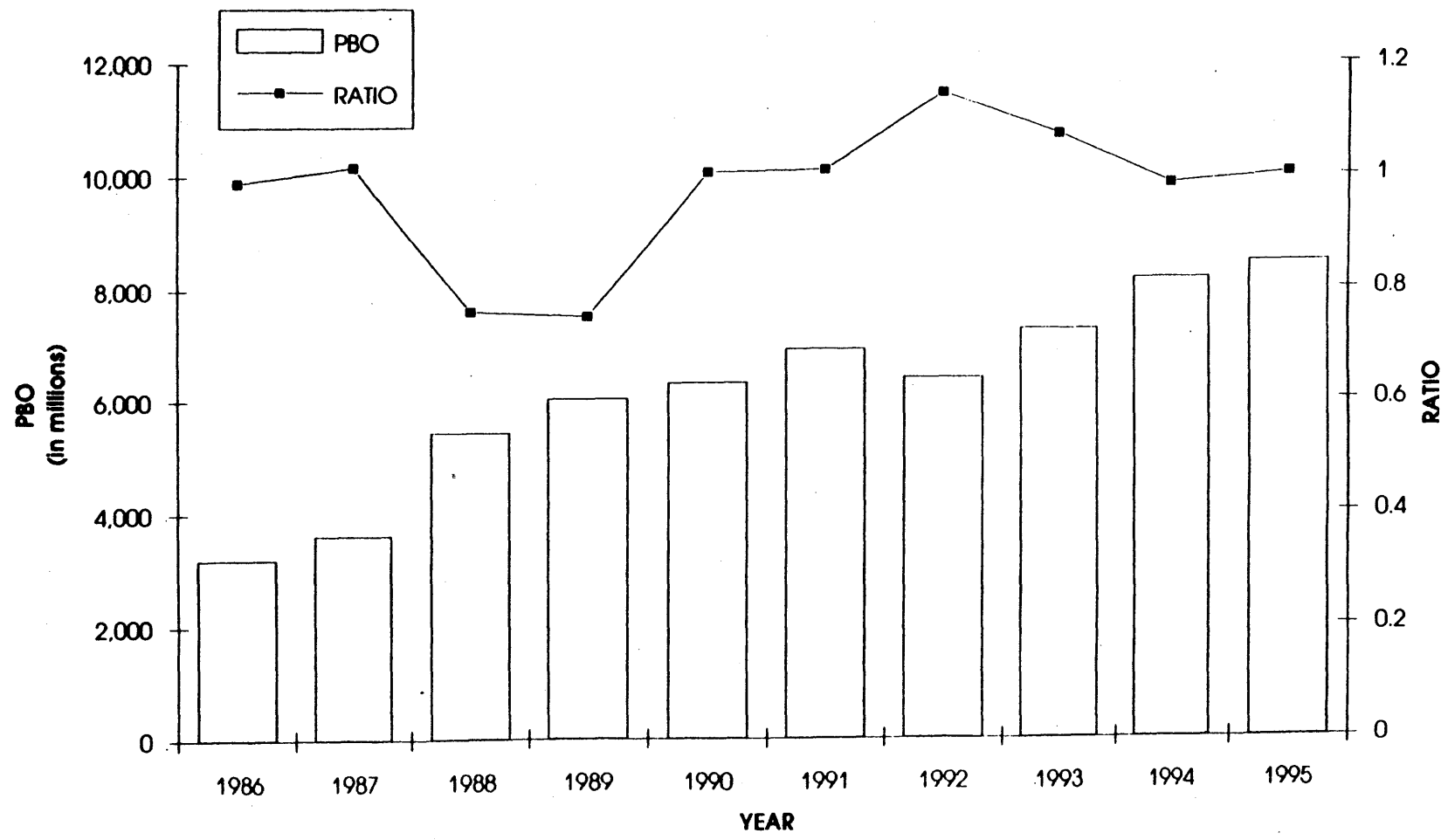
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PENSION BENEFIT OBLIGATION (PBO) AND FUNDED RATIO PERS-Total



**PENSION BENEFIT OBLIGATION (PBO) AND FUNDED RATIO
PERS-Local**



x7

D. Tracking of Unfunded Accrued Liability

	Basic Allowances	Active COLA	Window	Total
(1) Unfunded Accrued Liability as of March 31, 1994	\$(671,123,458)	\$ 1,728,031,386	\$ 116,853,499	\$ 1,173,761,427
(2) Interest on (1.) at 8.75%	(58,723,302)	151,202,746	10,224,681	102,704,125
(3) Gross Normal Cost	409,903,500	87,185,700	N/A	497,089,200
(4) Contributions Made	236,504,700	40,418,241	15,015,951	291,938,892
(5) Additional Window Liability	---	---	110,284,357	110,284,357
(6) Expected Unfunded Accrued Liability as of March 31, 1995 = (1.) + (2.) + (3.) - (4.) + (5.)	\$(556,447,960)	\$ 1,926,001,591	\$ 222,346,586	\$ 1,591,900,217
(7) Actual Unfunded Accrued Liability	\$(289,807,904)	\$ 1,757,564,183	\$ 222,346,586	\$ 1,690,102,865
(8) Gain/(Loss) for Year = (6) - (7)*	\$(266,640,056)	\$ 168,437,408	\$ 0	\$ (98,202,648)

* Analysis of Gain/(Loss) is discussed in Section IV.

E. Development of Required Contribution

1. Normal Cost	
a. Basic	\$ 68,593,842
b. Group Insurance Premium Fund	19,292,018
c. Active COLA	24,115,022
d. PRM premiums	127,459,410
e. Total	\$ 239,460,292
2. Accrued Liability	
a. Basic	\$ (16,612,571)
b. COLA	21,971,465
c. Window	*
d. Total	\$ 5,358,894
3. Total Contribution = 1(e) + 2(d)	\$ 244,819,186

* Actual contribution will depend on the payment schedule chosen by each location.

SECTION IV - COMMENTS CONCERNING THE VALUATION

The variation in liabilities and contributions reflects the Fund's actual experience during the year. The increase in the total contribution rate for basic allowances and active COLA from .63% to 1.83% was primarily due to unfavorable plan experience and the phase in of the revised actuarial assumptions.

The following table outlines the effect of the various items of actuarial experience:

• Investment Loss	+ .09%
• COLA increases less than expected	- .04%
• Loss on account of new members	+ .01%
• Pay increases less than expected	.00%
• Loss on account of new retiree COLA liability	+ .11%
• Loss on account of active experience	+ .14%
• Loss on account of pensioners' experience	+ .01%
• Phase-in of revised actuarial assumptions	+ .63%
• Phase-in of active COLA	+ .10%
• Other experience	+ .15%
• Total	+1.20%

(recognized immediately when you active the COLA liability 5000 up + 6000 vs. phase-in

With regard to the demographics of the membership between the 1994 and 1995 valuations, the number of active members increased by about 0.6% for all covered groups. Gross compensation increased by about 3.7%, which is attributable to an increase in average compensation. Between the March 31, 1993 and March 31, 1994 valuations there was an increase in the number of active members of about 1.2% and a 6.0% increase in gross compensation.

As might be expected, both the total number of pensioners and beneficiaries receiving benefits and the amount of benefits payable increased between the valuations. The average benefit payable also increased (from about \$1,358 per month to about \$1,462 per month). The increase reflects both the higher benefits