Commission on Government Forecasting and Accountability

PENSION IMPACT NOTE

103RD General Assembly

BILL NO: HB 5851 May 23, 2024

SPONSOR (S): Kifowit

SYSTEM: General Assembly Retirement System (GARS), State Employees' Retirement System (SERS), State Universities Retirement System (SURS), Teachers' Retirement System (TRS) and Judges' Retirement System (JRS)

FISCAL IMPACT

An actuarial study is required to determine the fiscal impact of HB 5851. An updated note will be issued once the study is complete. Under HB 5851, some of the major changes include changing the current funding goal to a 100% level by FY 2048 from a 90% level by FY 2045 and implementing a layered-amortization approach for a period of 20 years for the five State retirement systems.

SUBJECT MATTER: HB 5851 amends the five State System Articles of the Pension Code (TRS, SURS, SERS, JRS, and GARS). Some of the major changes in the bill include a new State funding plan with a goal of achieving 100% funding by FY 2048 and the implementation of a 20-year layered-amortization approach for any unfunded liabilities incurred after FY 2035. The bill redirects 50% of bond debt service from P.A. 93-0002 and P.A. 100-0023 towards the Pension Stabilization Fund for the purpose of making excess payments to the State Systems from FY 2030 - FY 2040. The bill also removes a provision requiring the Commission on Government Forecasting and Accountability (CGFA) to review and analyze the 90% funding ratio under P.A. 88-0593. Additional details regarding this legislation can be found in the Comment section below.

COMMENT:

State Funding Plan for the Five State Retirement Systems (TRS, SURS, SERS, JRS, and GARS)

Current Law

- The State shall contribute to the five State retirement systems a minimum required amount such that the required contribution is sufficient to bring the funded ratio of each system up to **90% by the end of FY 2045**.
- The annual required State contribution shall be calculated as a level percentage of payroll over the years remaining to and including FY 2045 and shall be determined under **the projected unit credit** actuarial cost method.
- **The 5-year asset and assumption "smoothing" methods** shall be used in order to mitigate the impact of any unexpected events or changes that may increase or decrease the State contribution.
    - With asset smoothing, implemented by P.A. 96-0043, which became effective on July 15, 2009, any gains or losses from investment fluctuations would be recognized in an equal annual amount over a period of 5 years.
    - Similarly, assumption smoothing, implemented by P.A. 100-0023, which became effective on July 6, 2017, serves to spread out the impact of any change in actuarial assumptions over the 5 year-period.
- Beginning in FY 2046, the minimum State contribution shall be the amount required to maintain the funded ratio of each system at 90%.

HB 5851

- HB 5851 would modify the current State funding plan for the five State retirement systems starting in FY 2026.
    - The FY 2025 State contribution would still be determined under the current funding plan.
- Major changes in the State funding plan would include:
    - Changing the funding goal to achieve 100% funding by FY 2048;
    - Starting in FY 2035, implementing a 20-year layered-amortization approach when determining the minimum State contribution; and
    - Using the entry age normal cost method beginning in FY 2049.

- Details on the modified State funding plan, categorized by three separate time periods, are discussed as follows:
    - For FY 2026 through FY 2034:
        - The minimum annual State contribution shall be determined by each system to be sufficient to achieve a **100%** funded ratio by the end of **FY 2048**. This contribution shall be calculated as a level percentage of payroll over the remaining years up to and including FY 2048, using the **projected unit credit** actuarial cost method.

  - **The 5-year Asset smoothing and assumption smoothing methods** shall continue to be used when determining the required State contribution, consistent with current law.

- For FY 2035 through FY 2048:
  - Beginning in FY 2035, a layered-amortization approach for a period of 20 years would be used when determining the minimum annual State contribution.
    - The minimum annual State contribution shall be the amount estimated for the upcoming fiscal year **plus an actuarial "layering" component**, such that the funded ratio of each system equals 100% **20 years** after the fiscal year during which the contribution is made.
    - This adjustment shall be implemented in equal annual amounts over a 20-year period beginning in the fiscal year in which the current actuarial valuation is used to determine the required State contribution.
    - Thus, the 5-year asset smoothing and assumption smoothing methods shall sunset after FY 2034 and would be replaced with the 20-year layered-amortization approach, beginning in FY 2035.

Table 1 below provides a graphic illustration of how a "layered amortization" program functions. The chart is for illustration purposes only, and is not an actuarial projection. The chart assumes an unfunded liability is generated in each valuation year shown at left. If the unfunded liability does not increase in the valuation year shown, there would be no 20-year "amortization layer" attributable to that fiscal year.

Table 1

Valuation Date June 30 (Fiscal Year)	Fiscal Year State Contribution Determined	The Effect of the 20-Year Layered Amortization for Fiscal Year										
		2034	2035	2036	2037	2038	...	2054	2055	2056	2057	2058
2033	2035		Amortization Layer Based on the FY 2033 Valuation									
2034	2036			Amortization Layer Based on the FY 2034 Valuation								
2035	2037				Amortization Layer Based on the FY 2035 Valuation							
2036	2038					Amortization Layer Based on the FY 2036 Valuation						
The layering process would continue each year in a similar fashion, extending beyond the determination of FY 2048 State contribution.												

  - When making these determinations, the annual required State contribution shall be calculated as a level percentage of payroll for the remaining years up to and including FY 2048, using **the projected unit credit** actuarial cost method.

- Beginning in FY 2049:
  - **The entry age normal** actuarial cost method shall be used instead of the projected unit credit actuarial cost method.
  - The State contribution would **not** need to be calculated as a level percentage of payroll.

- Any additional State contributions made under the Budget Stabilization Act shall not be considered when determining the minimum State contribution under the modified State funding plan in HB 5851.

Additional Pension Stabilization Fund Payments

HB 5851 would create additional payments to the Pension Stabilization Fund, made under the auspices of the Office of the Comptroller, as follows:

- **FY 2030: an additional $175 million would be paid into the Pension Stabilization Fund.**
- **FY 2031 through 2033: $250 million would be paid into the Pension Stabilization Fund.** This payment is equivalent to one half of the principal payments concluding in FY 2030 made by the state to pay off the $6 billion Income Tax Proceed Bonds issued under PA 100-0023.
- **FY 2034 through 2040: $750 million would be paid to the Pension Stabilization Fund in addition to any payments made towards achieving the goal of funding every pension system at 100% by 2048.** These payments are approximately equivalent to one half of the principal payments made under the Income Tax Proceed Bonds ending in FY 2030 and one half of the last principal payment made under the Pension Obligation Bonds issued under PA 93-0002 ending in FY 2033.

HB 5851 states that none of the aforementioned payments made to the Pension Stabilization Fund shall be used in actuarial calculations of required contributions to achieve the 100% funding goal at the end of FY 2048, as mentioned previously.

Commission on Government Forecasting and Accountability Analysis of 90% Funding Ratio

Under current law, the Commission on Government Forecasting and Accountability (CGFA) is required to review and analyze the state's goal of 90% funding of actuarial liabilities by FY 2045, and make recommendations every five years as to the efficacy of this funding goal. CGFA's most recent analysis was published in November 2021. HB 5851 would eliminate this requirement.

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