Tuesday, September 27, 2016 10:00AM
Joint Committee on Pension Systems Review
Remarks from the Comptroller General:

CHRMN: We're going to open it up with the Comptroller General. Thank you for being here.

ECKSTROM: Thank you very much. I can't think of an issue that is more urgently in need of attention and resolution. Now, I am going to be totally candid with you all this morning. If I say anything that offends any of you, I apologize for that upfront, that's not my intention. I regard each of you as my friends. But I do think that we need to be very frank about the state of the retirement system and how we got to where we are. Our roles differ a pretty good bit and because of that I think that we can look at similar events and reach vastly different conclusions--that's only natural. A hotel owner might look at a gathering rain storm and frown because it's going to impact his occupancy, while the groundskeeper can look at that same rain shower and smile because of the impact it will have on the grounds and the plants that he's responsible for. Two events, two people, two different responsibilities, two entirely different responses. That's natural. You may ask, "What does this young whipper-snapper know about the retirement system, about actuarial accounting?" I want to assure you that I'm not young; in fact, I attended my 50th high school reunion this summer. People had changed a whole lot in 50 years. Just think about how people can change--I had hair 50 years ago, believe it or not. Representative Stringer probably did, too--except, he wasn't born then, but he would have. I ran into one of my best friends in high school and I couldn't believe it. This guy was the jock, he lettered in three sports-- agile, trim, fit, and healthy, and the girl cheerleaders swooned over him. He was "the guy." 50 years later, he shows up and I hardly recognize the guy. He had moved on, moved out West and married someone he met in school, they moved west. I hadn't seen this guy in decades. He had gained 100 pounds and was having these serious health problems because of that. I asked him, "How could that have happened?" You know what he told me? He said, "It all happened so slowly, I didn't even realize it. I finally came-to when my doctor diagnosed some really serious health problems. But it all happened in bits--a pound here, and a pound there. There was never a year when I gained a lot of weight. It was just a problem that occurred incrementally over time."

I wonder if you all recognize that that is kind of the situation we have on our hands with the retirement system. You all have, in the material I provided, a table--and I know that the table is very, very busy--it goes back to 1997 and comes forward to 2015. We're waiting for the 2016 actuarial evaluations. But it shows that in 1997 we were in pretty good shape. In 1999 in fact the state had an unfunded liability of about $200M. The actuaries were projecting based on contribution rates it would take about 2 years to liquidate that unfunded liability. The charts that follow that table, the first one shows that the unfunded liability grew dramatically, and those are the green columns. It grew from almost nothing in 1999 to about $16.8B in 2015, and that our amortization period for liquidating that liability has, well our funding percentage, rather, the percentage that we've funded into the system to cover the liability has dropped from nearly 100% in 1999 to just over 60% today; meaning, that of the dollars that are supposed to be there, or, for every $10 that we should have in the system, we have only $6, [meaning] $4 of the $10 are missing and need to be replaced. They're missing because they were never put in. How could that be? Well, the next chart shows essentially the same thing. It shows the percentage that the plan is funded but compares it to the liability amortization period and it shows that it'll take us 30 years to amortize the existing liability, if we're lucky. We're right at that point where the actuaries tell us, and the accounting standards tell us, our plan is actuarially unsound if we breach that 30 year amortization period. And we've been there essentially since about 2004. The next slide shows some of the factors that have contributed to the system's underfunding, some of the factors that have built up this unfunded actuarially-determined liability. Now that's a really fancy term, "unfunded actuarially accrued liability." That's a term that we don't use in everyday life so I'll give you a term or two to substitute for it. You could replace that term "unfunded actuarially accrued liability" with the term "deficit." Or if you have any questions over what a deficit is, you can use the four letter term "debt." You might say "But that's the retirement system's debt." Not really, that's state debt. That's debt that the state has an obligation to make up. It's debt that the state has an obligation to liquidate. It is money that the state has an obligation to pay into the system, has to put into the plan. Now you might ask, "What's the problem here?" Let me tell you upfront not to jump to the easy conclusion that the RSIC [Retirement System Investment Commission] is the cause of all this problem. That's an easy horse to kick. It's an easy entity to point the finger of blame at. Now some of that blame might be justified, but to look at the RSIC as the primary cause of the growth in the unfunded liability just does not square with the facts. There are many other contributors, many other factors that have created that debt, which is the state's debt.

One of them is the way we oversee, the way we assign responsibility, for the retirement system. It's one of the most fragmented, patchwork systems of oversight conceivable. If you wanted to design a less effective system of oversight and responsibility, you'd have to try pretty hard. In fact, I don't know how you could do it. The retirement system itself has a piece of responsibility. PEBA has a piece of responsibility. The Fiscal Accountability Authority, the authority that I'm on, has a piece of that responsibility. And you all in the General Assembly have a piece of that responsibility. No one has total responsibility, no one has total access, no one has the ability to make decisions overall to provide for the absolute needs of the retirement system because we have fragmented this oversight and responsibility. This [assigned oversight] has changed over the years. The Budget and Control Board, the predecessor of the Fiscal Accountability Authority, used to have the ability to control employer contributions, while you all in the General Assembly retained the authority back then to control employee contributions. So there was this bifurcated responsibility back then that didn't work out all that well. But there have been other changes, especially when PEBA was created by the General Assembly and given the opportunity to set contribution rates [for both employers and employees]. But the General Assembly retained the responsibility to control one of the most critical estimates used in projecting the liabilities of the retirement system-- and that is the critical estimate for the discount rate used to calculate the present value of the future liabilities of the plan. It seems to me that the intention was very clear that the General Assembly did not want others making decisions that could impact annual funding of the retirement plan. But you all have artificially held high the discount rate, the rate that's used in calculating the liability, and by doing so are understating the liability. I know that's not been the intention of any of you, but I call it almost "benign neglect" to tolerate that. Those of you who are interested in solving this problem will never get it solved without giving up that responsibility [to PEBA]; because, like the hotelier and the groundskeeper, you all [as the plan's funders] have a very different outlook [than the plan's primary overseer] on retirement system decisions. You all are looking at the retirement system on a year-to-year basis. You're making decisions in order to help craft an annual budget and I applaud you for that. I know that that's something you've got to do, to pass an annual balanced budget for the state. But in connection with that, you've limited the funding needed by the retirement system which, by the way, has provided you all with the opportunity to free-up a little funding for projects back in your districts. That's always required a tradeoff with the retirement system's funding needs. Really that's what the supplemental appropriation bill is all about, giving so many of you an opportunity to fund projects in your districts. When, in my mind, the state has this very high priority funding need that's been largely ignored because it's been suppressed by the differing views, the annual view as opposed to the long term view. In the long term view that I take as a member of the Fiscal Accountability Authority – looking at the long term health of the plan – it is abundantly clear that the long term health of the plan is in peril, and I don't know how in looking at the growth of the unfunded liability anyone could escape the conclusion that there's a trajectory that's been set that's damaging the plan, and that the state has really missed the mark in operating it. I know some of you here today have been deniers of that by saying that it's not a problem. I'm very glad we're now all on the same page and that we all admit that yes, there is a problem. And the question now is "How are we going to fix it?" We've willingly received information, and used information, that just doesn't seem that reasonable. We've received it from our experts. I think that there are times that we've driven experts to give us information that's favorable and user-friendly to keep the retirement system debt, the unfunded liability, down to a lower level. I've seen it happen, I've seen the actuaries provide information which results in not what the state wants, and the actuaries reconsider and come back with more favorable information. This "getting by" approach that we've taken has gotten us to where we are today. How do we get out of it? I don't think that we ever will [get out of it] without addressing the oversight problem, without addressing the "who controls what" problem. I think the state has to provide for competent oversight, and give that competent oversight the [necessary] authority to be able to hold it accountable for the system. We've had people who have been responsible [to one extent or another], but I think that there's too much blame to go around to start pointing fingers at any one party, because there's been a lot of complicity in the very big problem that we have on our hands today. Just think about, years and years from now, when you retire, your grandchildren, maybe your neighbors, asking you, "What did you do to fix the retirement system? We heard the retirement system used to be in trouble, tell us what you did to fix it." What are you going to be able to tell them? What will you be able to say? We now realize it has to be fixed. The question is "When do we want to fix it, and who will?" You all control that part. Thanks for letting me speak today. We're all in this together.