maine PERS
Public Employees
Retirement System

Sandra J. Matheson, *Executive Director*

DATE: March 13, 2017

TO: Senator James Hamper, Chair
Representative Drew Gattine, Chair
Members, Joint Standing Committee on Appropriations and Financial Affairs

FROM: Sandra J. Matheson, Executive Director Sandy Matheson

SUBJECT: Testimony on L.D. 723 – Resolution, Proposing an Amendment to the Constitution of Maine to Reduce Volatility in State Pension Funding Requirements Caused by the Financial Markets

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Good afternoon Senator Hamper, Representative Gattine, and members of the Joint Standing Committee on Appropriations and Financial Affairs. My name is Sandy Matheson, and I am the Executive Director of the Maine Public Employees Retirement System.

MainePERS thanks Senator Katz and the co-sponsors of this bill for sponsoring, at our request, LD 723, An Amendment to the Constitution of Maine to Reduce Volatility in State Pension Funding Requirements Caused by the Financial Markets.

MainePERS originated and requested sponsorship of LD 723 because we believe changing the amortization period for market and other experience losses is a financially sound move that can help stabilize funding of the State/Teacher Retirement Plan as it moves toward 100% funding.

Currently, the State Constitution requires that investment gains and losses be amortized, or recovered, over a ten-year period. This was adopted in 1995 following a time in the 1980's when the Plan, at less than 28% funded, was one of the three lowest funded plans in the country. Without aggressive measures, the Plan at that time was in potential danger of not being able to pay benefits in the future. The cooperative commitment to honoring the Plan's liabilities led to the 1995 Constitutional amendment and the aggressive provision to repay market and other experience losses within ten years. This is one of the key reasons that the Plan is currently funded at 80% 22 years later. The Plan has not only moved from one of the three lowest funded, but has earned in a short period of time the remarkable distinction of ranking in the top 25% of funding levels across the country.

While the ten-year amortization provision was once key to stabilizing the Plan, it now works to destabilize the Plan as it moves toward full funding. This is because market losses on a plan funded at 80% are substantially greater than market losses on a plan funded at 28%. For example, a plan with $10B in liabilities that is 28% funded has $2.8B in assets; a plan with the same liabilities that is 80% funded has $8B in assets. If there is a 10% loss of the fund value due to a market correction, the amount to be recovered by the well-funded plan is $80M versus $28M for the poorly-funded plan. This in turn has a greater budget impact and is more challenging to pay back through contributions.

The current 10-year provision has served the Plan well, but in actuality is lower than currently recognized actuarial standards of 15-20 years. While many peer plans continue to use 25-30 year amortization periods, MainePERS recommends that responsible stewardship of this plan at this point in time is to change its 10-year amortization to 20 for the previously stated reasons. Our actuary concurs with and strongly supports this recommendation.

This proposal applies to all of the existing ten-year amortization schedules and all future experience gains and losses. It does not apply to the 1996 UAL that has to be retired by 2028.

The financial impact of this change is two-fold. The first is that annual contributions are lower when experience losses occur because they are being recovered over twenty years instead of ten. The second is that the total cost of recovering losses increases because it is being recovered over a longer period of time. One of the closest examples to understand why this occurs is to think of changing a 15-year mortgage to a 30-year mortgage. You pay greater costs over time in exchange for a lower monthly payment.

Thank you for your consideration of this bill. MainePERS and our actuary recommend this as a stabilizing practice for the State/Teacher Retirement Plan. I would be happy to answer your questions and will be available at the work session.