Memorandum

TO: House Government Operations Committee
FROM: Jeff Fannon, Executive Director
DATE: March 25, 2021
RE: Pension Governance Proposal

I am here today to speak about the "Proposed Pension Governance Changes" document released yesterday. The question I am left with is, what problem are we trying to solve with these proposed governance changes and what part did the several boards play in the fiscal challenges. Some may say that because of the draconian nature of the plan design proposal this governance proposal is small potatoes not worth addressing or arguing about. I do believe, however, that the board composition matters today as well as tomorrow and examining the instant proposal is a worthy conversation.

The current retirement boards did not cause the current problems that have been identified to me since we started meeting with the Treasurer in November. The problems were fiscal in nature, specifically, the ADEC and unfunded liability increased significantly last year. The boards did not cause these problems, and instead, we need to ask why did these two numbers increase so much in one year. I believe there are three reasons why these increased and they are well known.

1. In the case of the teachers' retirement system, VSTRS, the state for many years underfunded the plan. This is well documented and totals hundreds of millions of dollars. Indeed, in the late 1990s a teacher member of the VSTRS board, Jay Kaplan, went so far as to file a lawsuit against the state for this underfunding, and the settlement of that lawsuit led to passage of the law requiring the Governor to identify when the administration's proposed budget does not include full funding of the plan. In other words, it as the teacher member who raised the alarms nobody else. Diluting the member voice of those most affected by the state's decision is alarming and not supported by past experience.

2. The actuarial assumptions were not accurate. The board hired outside actuaries, so-called experts, to make recommendations and advise the board about the plan's demographics and, therefore, plan decisions would then be based upon such recommendations. We learned last year that the actuaries' assumptions and recommendations were not accurate, but the board did not make the recommendations, i.e., board composition is not to blame. These inaccurate assumptions caused sizable financial increases we are all trying to react to now, but the board does not need correction it is the actuaries who we should be examining.

3. The rate of return was lowered in November last year and that added significantly to the fiscal issues. Again, the board hired outside Wall Street advisors who made the

> recommendation upon which the board relied. The board operated as it should have and the law requires, it did its due diligence, but it turns out the Wall Street experts were not too expert in their rate of return recommendation and now the board lowered the rate of return to make up for this earlier prediction. Again, the board did not cause the problem and “fixing” the board does nothing to examine and address the underlying problem.

The current composition of the board is perfectly in-line with the recommendation of the Boston College Center for Retirement Research. That Center examined board composition and suggested a board that is largely as we have it now, and we should not attempt to fix a problem that, frankly, isn’t a problem with the composition of the board. The BC research group recommends a board of 6-10 members (we have 6 now) and the proposal calls for 15 members, which far exceeds the research. Moreover, the proposal overly uses political appointees, which BC specifically recommends against, and the proposal does so thereby diluting stakeholder voice and that, again, contradicts the research recommending sufficient stakeholder representation on retirement boards. In large, we have the right mix now. Certainly, the BC Center recommends “at least two [board] members with financial or actuarial experience,” and that change is worthy of discussion. Making wholesale changes, as the proposal does, however, is not advisable and should be avoided, especially since the current board did not cause the problems before us.

By way of a recommendation, we should examine how boards of other plans operate, including Taft-Hartley plans that are jointly administered by equal numbers of employee representatives and employer representatives. Making such large changes, as the proposal suggests, should be thoughtfully undertaken and not hastily acted upon.

Thank you and I am happy to answer any questions.