

January 5, 2011



**COLORADO
PERA®**

Presentation for the Joint Budget Committee

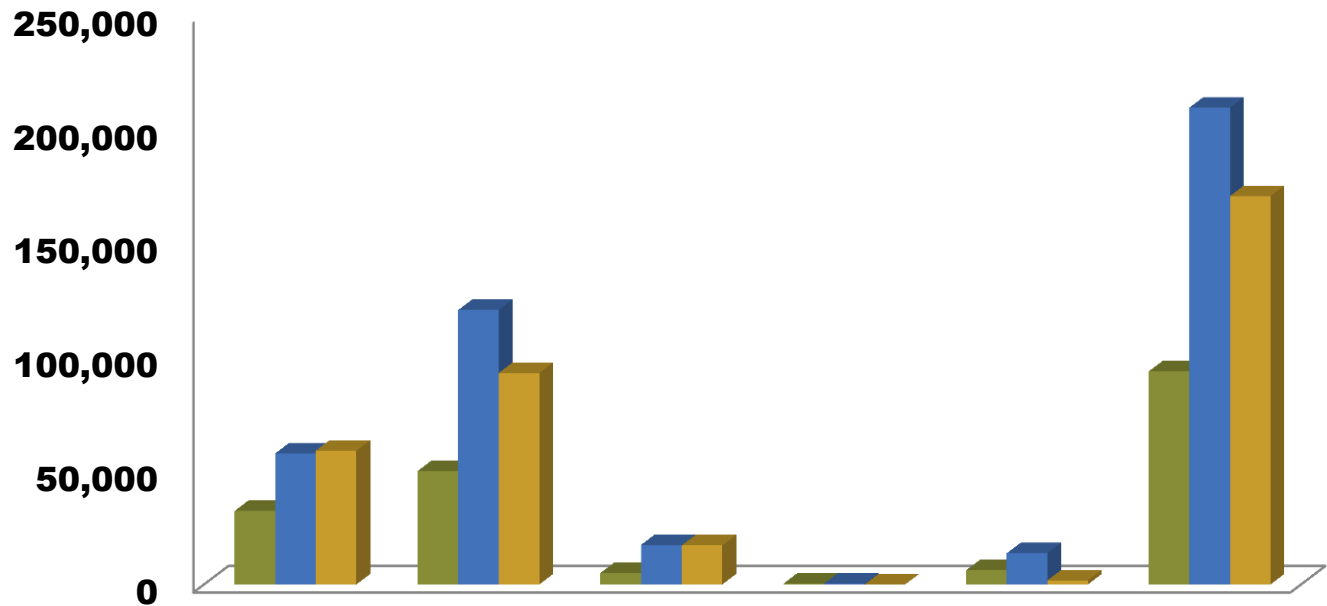
Colorado PERA's Mission Statement

To promote long-term financial security for our membership while maintaining the stability of the fund.

PERA Membership

November 30, 2010

Total: 473,456



	State	School	Local Gov't	Judicial	DPS	Total
Benefit Recipients	32,257	49,753	5,004	291	6,265	93,570
Active Members	57,526	120,463	17,352	314	13,703	209,358
Inactive Members	58,749	92,852	17,151	12	1,764	170,528

PERA Financial Recap

(in thousands of dollars; does not include defined contribution plans)

\$35,695,328* net assets as of December 31, 2009

November 2010

Contributions \$1,635,167	
Employer - Pension	\$828,771
Employer - Health Care	\$71,570
Member	\$571,247
Purchased Service	\$29,542
Retiree Health Care Premiums	\$105,212
Medicare Retiree Drug Subsidy	\$14,671
Other Additions	\$14,154

Investments \$2,856,382	
Net Change in Fair Value	\$2,174,481
Interest	\$313,807
Dividends	\$326,967
Real Estate/Opportunities/ Alternative Investments	\$146,357
Securities Lending	\$13,065
Investment Expense	(\$118,295)

Benefits Paid (\$3,287,302)	
Pension Benefits	(\$2,892,353)
Health Care Benefits	(\$181,472)
Disability/Life Insurance	(\$4,849)
Refunds	(\$160,634)
Other	(\$9,571)
Admin Exp	(\$38,423)

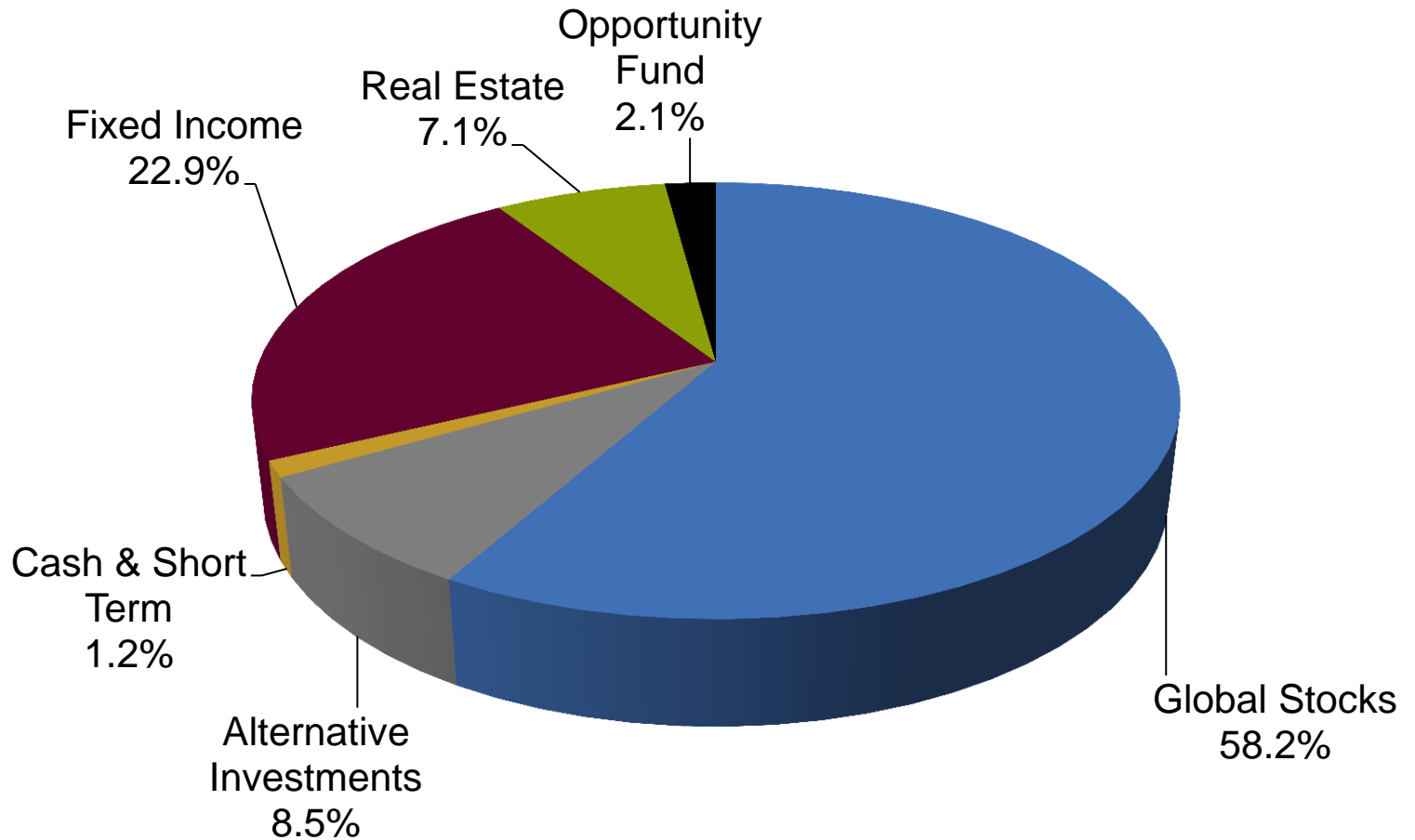
\$36,899,575 net assets as of November 30, 2010

** Includes \$2,764,076 of DPSRS assets transferred on January 1, 2010
(unaudited, for internal use only)*

Investment Asset Allocation

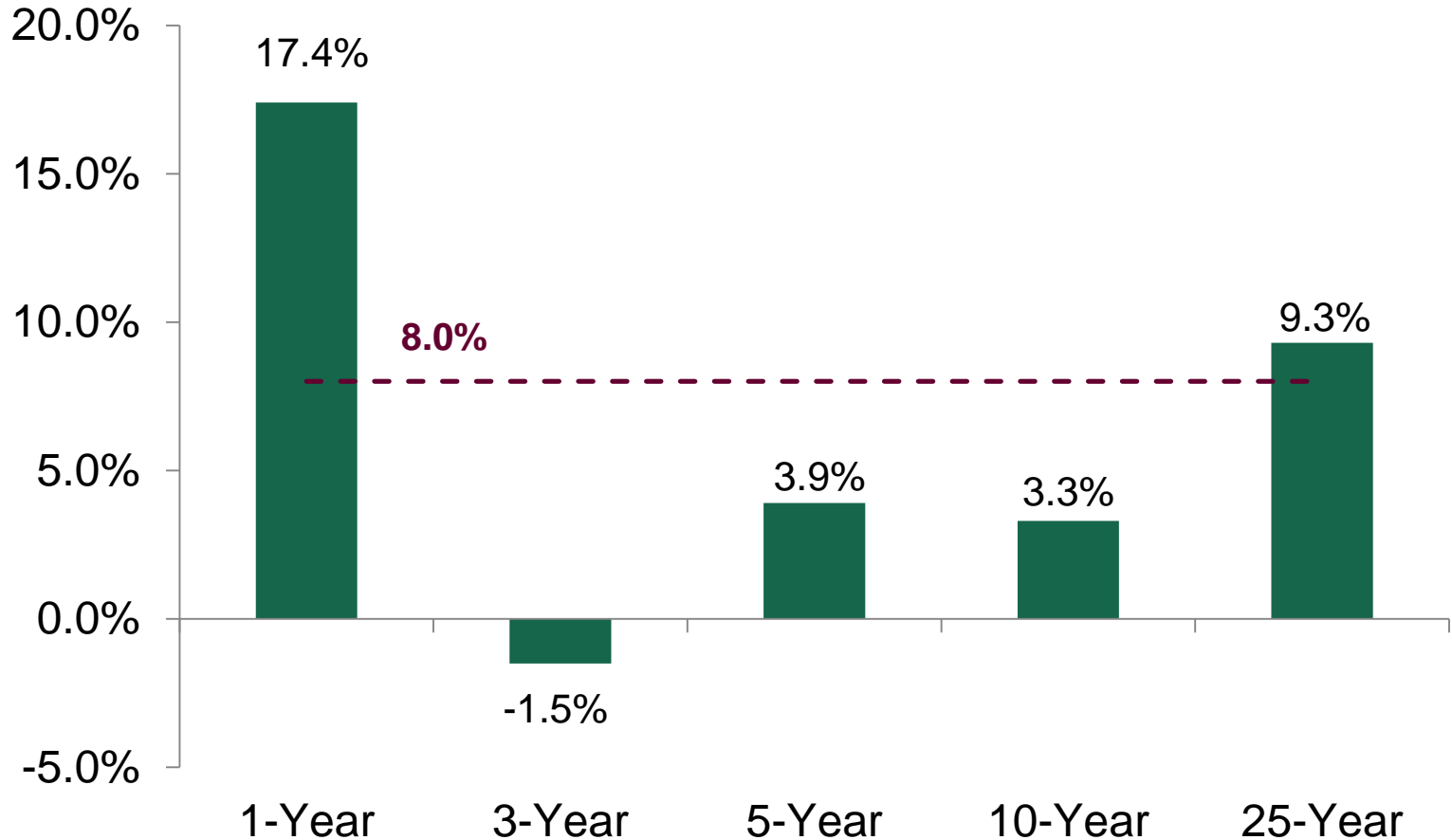
December 24, 2010

\$38.2 Billion Market Value



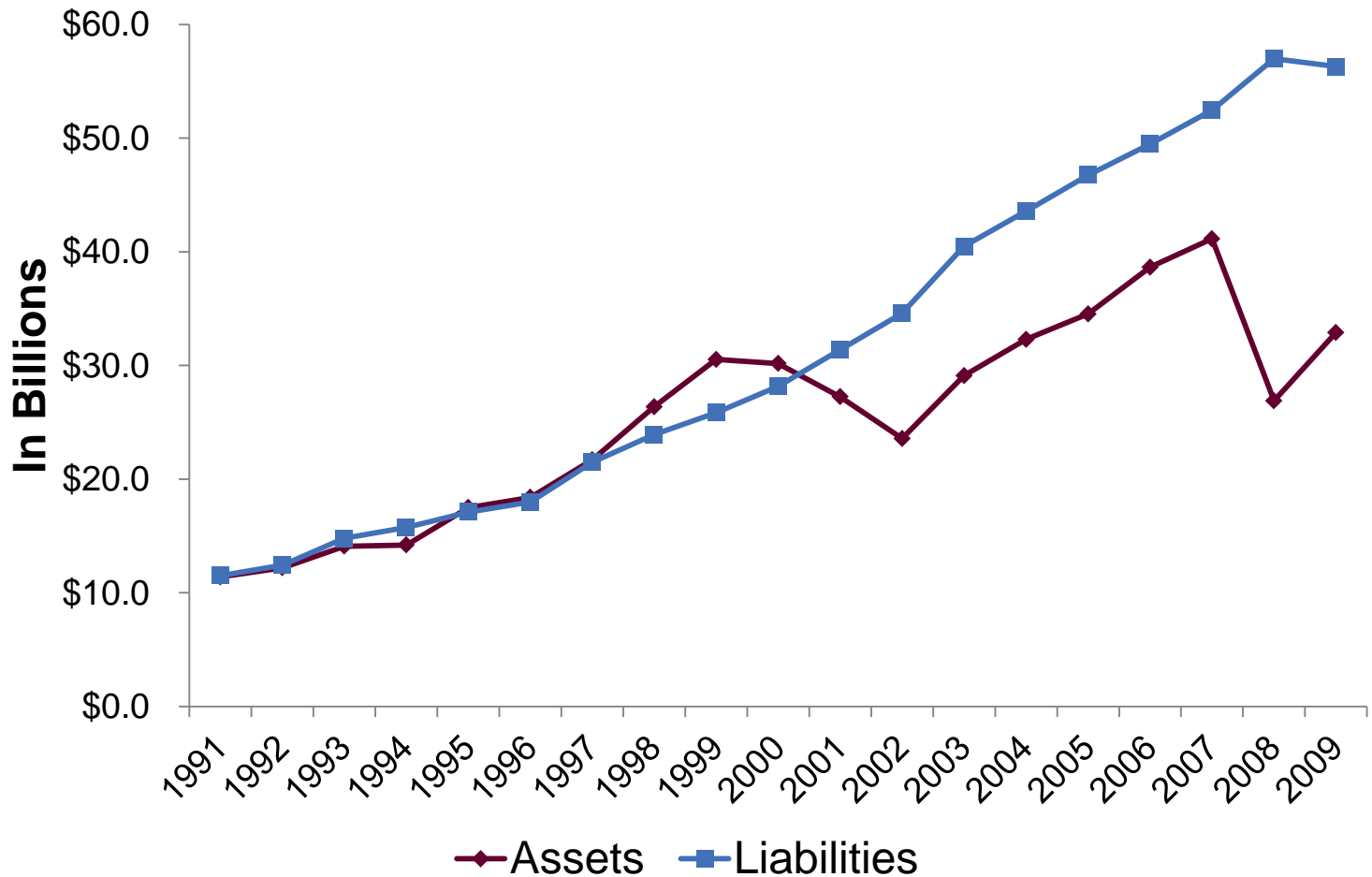
Investing for Long Term

Annualized investment returns for periods ending December 31, 2009

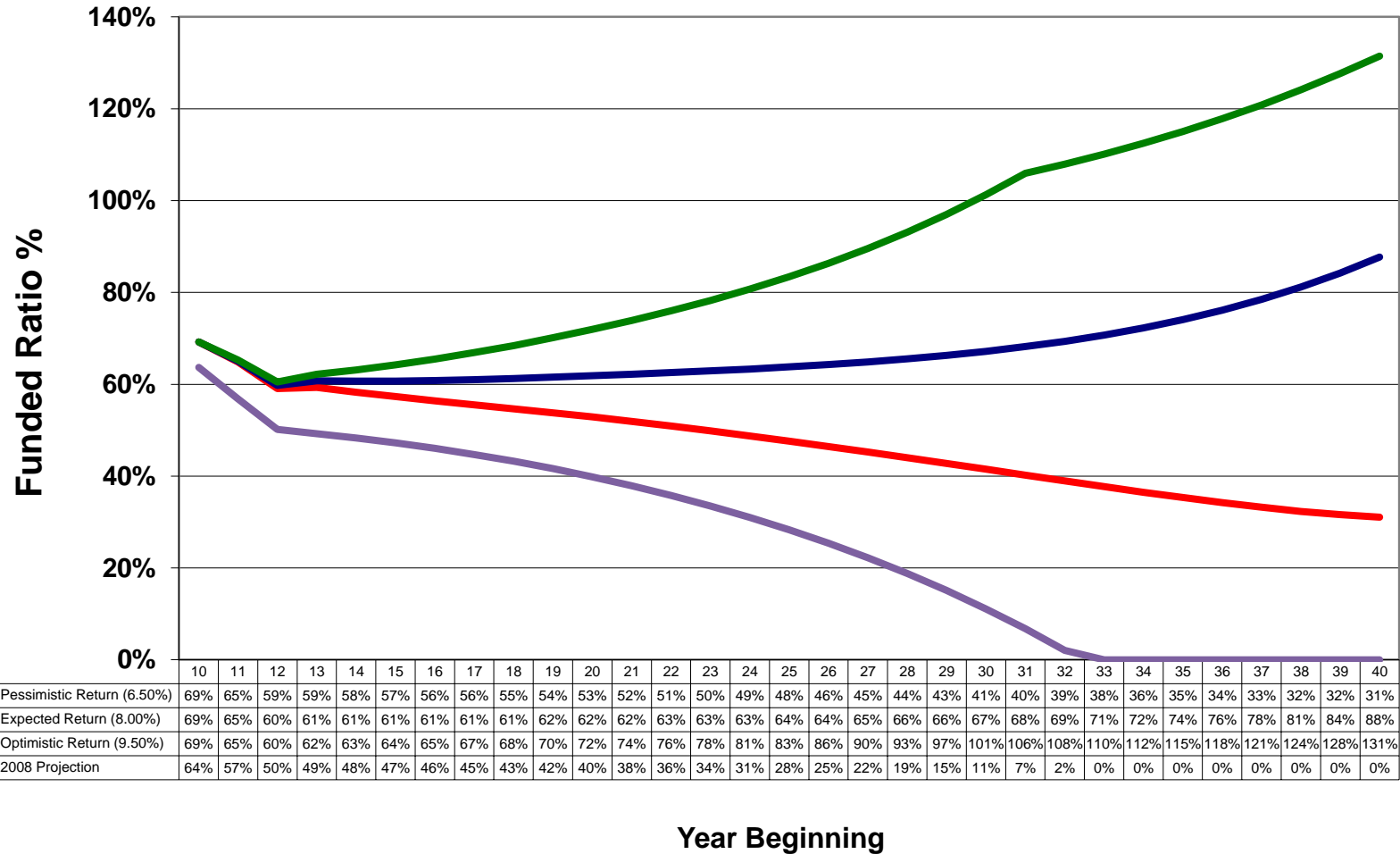


PERA Assets vs. Liabilities

Market Value as of December 31 for each year

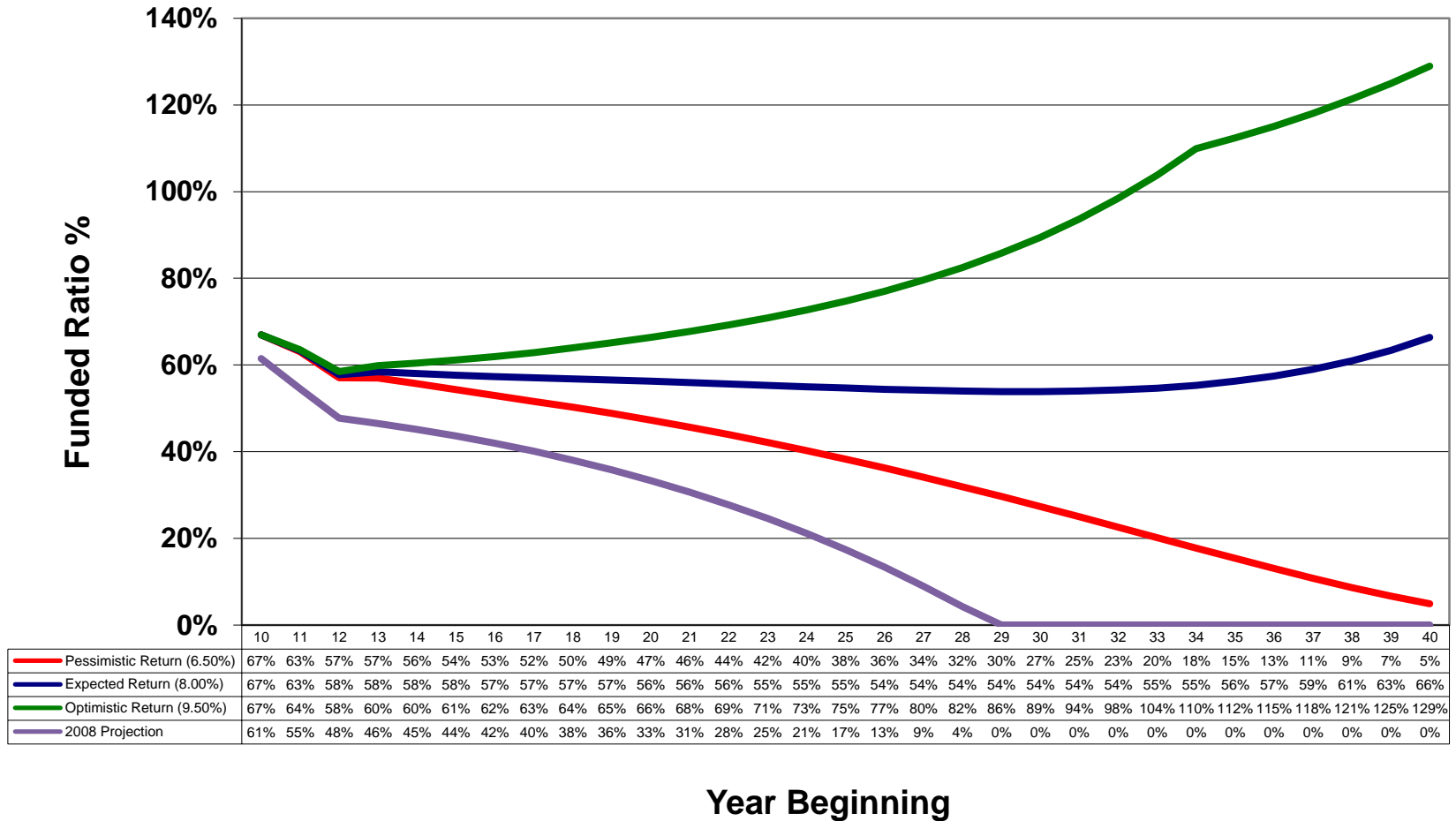


School Division Actuarial Projection



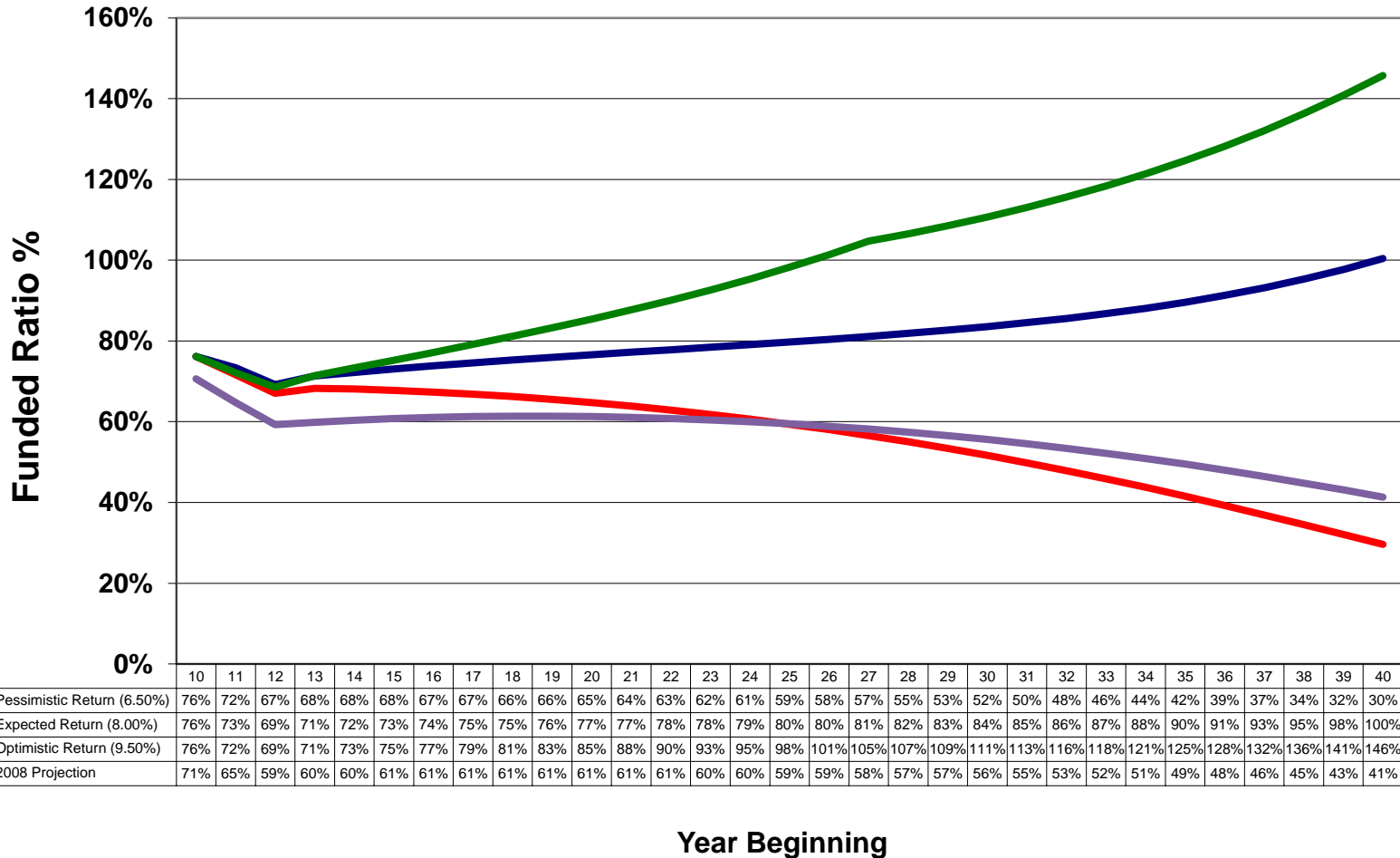
— Pessimistic Return (6.50%)
 — Expected Return (8.00%)
 — Optimistic Return (9.50%)
 — 2008 Projection

State Division Actuarial Projection



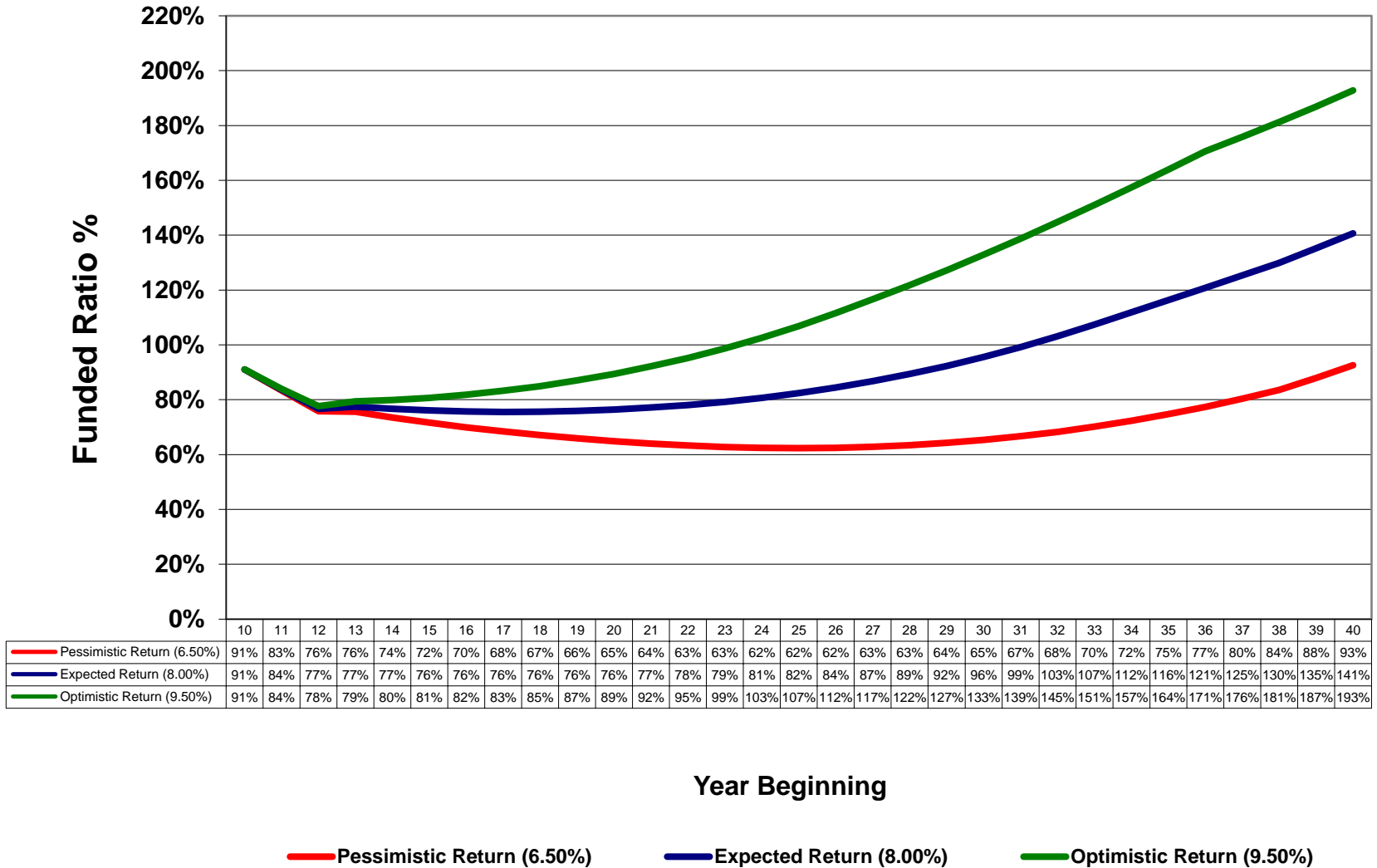
— Pessimistic Return (6.50%)
 — Expected Return (8.00%)
 — Optimistic Return (9.50%)
 — 2008 Projection

Local Government Division Actuarial Projection

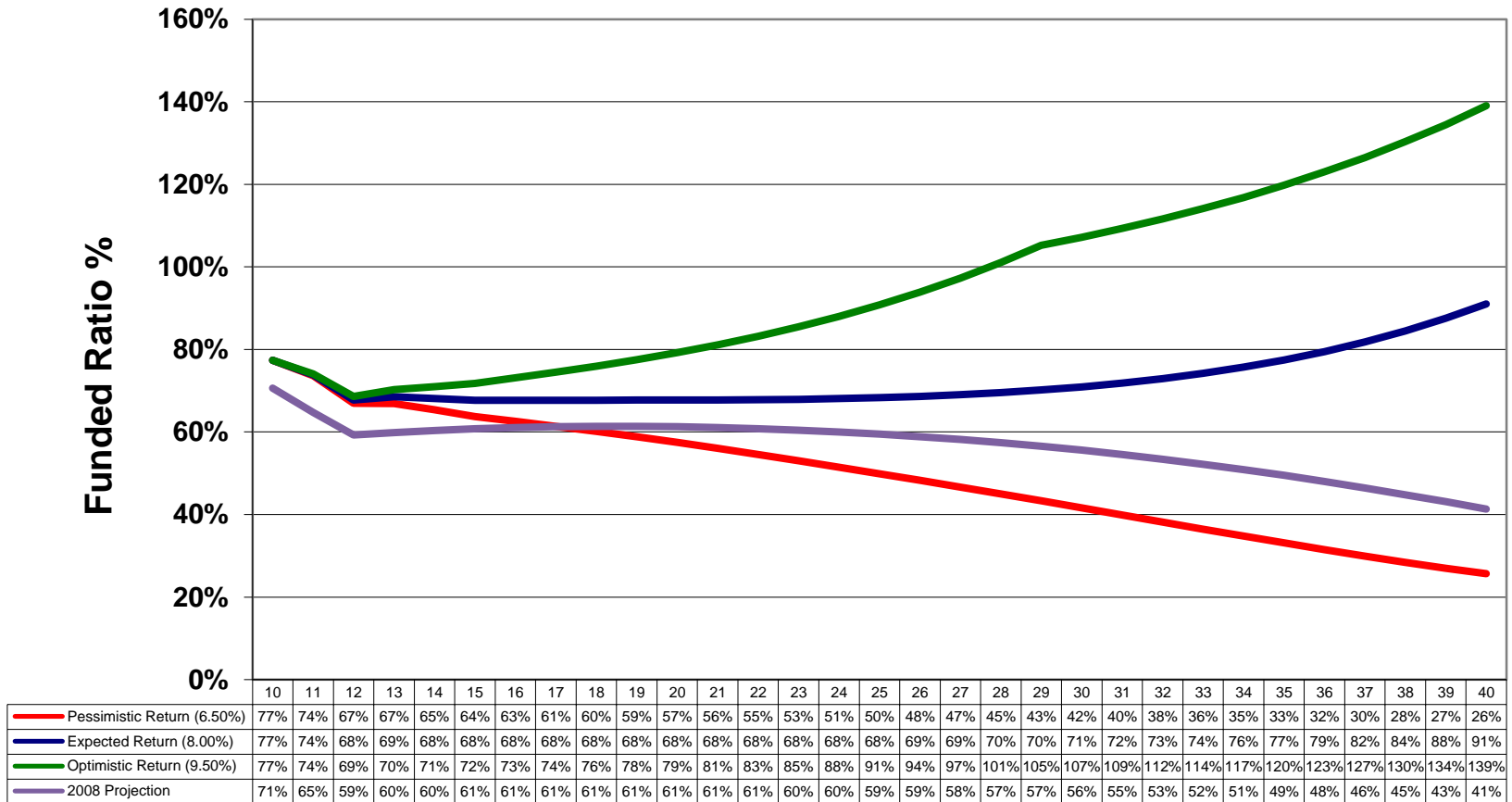


DPS Division

Actuarial Projection



Judicial Division Actuarial Projection



Year Beginning

— Pessimistic Return (6.50%) — Expected Return (8.00%) — Optimistic Return (9.50%) — 2008 Projection

PERA's DC Plans

Plan	Who's Eligible	Participants (As of September 30, 2010)	Assets (As of September 30, 2010)
401(k)	All PERA members and retirees	74,350	\$1.78 billion
PERA DC	State employees hired in 2006 or later Community College employees hired in 2008 or later	3,355	\$47 million
457	State employees and employees in some school districts	18,221	\$423 million



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December 30, 2010

Ms. Sara Alt
Vice Chair
Board of Trustees
Public Employees' Retirement Association of Colorado
1301 Pennsylvania Street
Denver, CO 80203-2386

Dear Ms Alt:

This is to confirm our opinion that the comprehensive plan of benefits and contribution changes enacted into law earlier this year under SB 10-01 continues to be a sound actuarial response to PERA's current financial situation. It is a reasonable approach to ultimately achieving the goal of fully amortizing the unfunded actuarial accrued liability of PERA's divisions and thereby reaching a 100% funded ratio for each division within the next 30 years. The impact of the actual experience for PERA during 2009, as reflected in the projections performed in conjunction with the December 31, 2009 actuarial valuation, does not alter our opinion about the ability of PERA's divisions to ultimately reach full funding.

In addition, please keep in mind that we are unable to incorporate two benefit changes made by SB 10-01 into the projections. The two items are:

1. A change in the method of determining the total benefit payable to a retired member who returns to work and subsequently re-retires.
2. The elimination of the indexing of benefits for vested inactive members with at least 25 years of service from date of termination to date of benefit commencement.

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Ms. Sara Alt
December 30, 2010
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Overall these changes are expected to reduce the liability for benefits in the future and will be helpful in attaining the goals laid out by the Board, but together they do not have a significant impact on the projected liabilities of the Divisions.

If we can provide any further details regarding these issues, please do not hesitate to contact us.

Sincerely yours,

A handwritten signature in blue ink that reads 'Thomas J. Cavanaugh'. The signature is fluid and cursive, with a long, sweeping underline.

Thomas J. Cavanaugh, FSA, FCA, EA, MAAA
Chief Executive Officer

TJC:kc

**PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION (PERA)
FY 2011-12 JOINT BUDGET COMMITTEE HEARING AGENDA**

**Wednesday, January 5, 2011
11:00 am – 12:00 pm**

11:00 – 11:05 INTRODUCTIONS AND OPENING COMMENTS

11:05 – 11:20 PRESENTATION, PUBLIC EMPLOYEES' RETIREMENT ASSOCIATION

11:20 – 11:35 CONTINUATION OF S.B. 10-146

Background: During the 2010 legislative session, the Joint Budget Committee sponsored S.B. 10-146, which *decreased* the employer's (State) PERA contribution amount by 2.5 percent and *increased* the employee's PERA contribution amount by 2.5 percent. The legislation is effective for one year only, FY 2010-11, and impacts the State and Judicial divisions *only*. The legislation reduces General Fund expenditures by approximately \$20.0 million for FY 2010-11.

1. Has PERA analyzed the impact of continuing the 2.5 percent employer-employee contribution swap for the State and Judicial divisions?

PERA Response: The actuarial impact of continuing the swap is discussed below in PERA's response to question 2. In addition to the actuarial impact, PERA is concerned about the possibility of litigation that would challenge the constitutionality of the swap. We have received contact from several individuals and member organizations who have indicated that they are considering filing suit to challenge the swap.

- a. Is the contribution swap constitutional?

PERA Response: The Federal and State Constitutions contain a Contract Clause, which prohibits the State from enacting any law that impairs the obligation of any contract. PERA believes that the test set forth in the case of *In re Estate of DeWitt*, 54 P.3d 849 (Colo. 2002) is the proper standard for analyzing cases regarding impairment of contracts. This test is discussed in more detail below in the section regarding SB 10-001 litigation.

PERA notes that there is currently a case pending in New Mexico against the State and the pension fund for the same swap arrangement that was put in place last year in Colorado through SB 10-146. The case is set for a motions hearing on January 12, 2011. PERA will monitor the case as it proceeds in litigation. (*American Federation of State, County & Municipal Employees, et al. v. State of New Mexico, et al.*, case D-202-CV-200907148).

- b. Is PERA aware of how its members feel about this action?

PERA Response: PERA has received mixed feedback from its members regarding the swap, largely based on how close the members are to retirement. Many feel that it is unfair to balance the State's budget through the swap and have expressed concern about the Constitutionality of the action. While other members feel it is a more equitable solution than

General Fund and Cash Fund furloughs while not negatively impacting a members' Highest Average Salary for pension purposes.

2. Would continuing this legislation for another year (through FY 2011-12) impact PERA's unfunded liabilities, and if so, how?

PERA Response: Continuing this legislation for another year would have a negative impact on the funding status of the State and Judicial Divisions by increasing unfunded actuarial liabilities. PERA's actuaries have analyzed the impact of legislation continuing the effects of SB 10-146 for one year, as follows:

- State Division: \$6.6 million
- Judicial Division: \$0.04 million

3. How would PERA's unfunded liabilities be impacted if the employee contribution amount remained at the increased 2.5 percent rate (10.5 percent for the State and Judicial divisions, and 12.5 percent for State Troopers), and at the same time the State's contribution amount returned to the rate prior to S.B. 10-146 (10.15 percent for the State division, 12.85 percent for State Troopers, and 13.66 percent for the Judicial division)?

PERA Response: Continuing this permanently would have a negative impact on the funding status of the State and Judicial Divisions by increasing unfunded actuarial liabilities. PERA's actuaries have analyzed the impact of legislation continuing the effects of SB 10-146 permanently, as follows:

- State Division: \$38.6 million
- Judicial Division: \$0.1 million

4. How would the continuation of S.B. 10-146 impact the Amortization Equalization Disbursement (AED) contributions and the Supplemental Amortization Equalization Disbursement (SAED) contributions?

PERA Response: The AED and SAED are completely separate from the contribution swap as provided in S.B. 10-146. S.B. 10-146 impacts the employer contribution and the member contribution percentage as provided in C.R.S. § 24-51-401 for the State and Judicial Divisions. The AED and SAED percentages are provided in C.R.S. § 24-51-411.

11:35 – 11:50 SENATE BILL 10-001

5. What is the status of the lawsuit regarding S.B. 10-001?

PERA Response: In March 2010, Plaintiffs filed their amended complaint challenging the reduction in the annual increase percentage, which was enacted by the Colorado General Assembly on February 23, 2010. The Annual Increase (Cost of Living Adjustment or COLA) percentage was reduced from a fixed 3.5 percent to an increase that is currently capped at 2

percent (S.B. 10-001 provided a mechanism that automatically adjusts the COLA cap up from 2 percent in the future based on the funded status of the plan). The law provides that the amount of the Annual Increase will be 2 percent unless PERA experiences a negative investment return year, at which point the percentage of the annual increase for the subsequent three years would be the lesser of the CPI-W or 2 percent. The named Plaintiffs claim to represent a class of individuals who are all retirees or members who were eligible to retire as of the SB 10-001 effective date. The complaint is against the State of Colorado, Colorado PERA, Governor Bill Ritter, and Colorado PERA's Board of Trustees' Chair and Vice Chair in their official capacities. Plaintiffs assert eight claims for relief alleging violation of: 1) the Contract Clause of the Colorado Constitution, 2) Article V, § 38 of the Colorado Constitution 3) the Contract Clause of the United States Constitution, 4) the takings clause of the United States Constitution, 5) the right to substantive due process guaranteed by the 14th amendment of the United States Constitution, 6) section 42 U.S.C. § 1983- Contract Clause- Individual Defendants in their official capacities, 7) section 42 U.S.C. § 1983-takings clause- Individual Defendants in their official capacities and 8) section 42 U.S.C. § 1983- Substantive Due Process- Individual Defendants in their official capacities only.

In May 2010, PERA filed a motion to dismiss each claim except the contract clause claims. The Court dismissed claim two based on Article V, § 38 of the Colorado Constitution but did not dismiss the other five claims that PERA sought to have dismissed. The Court also limited the relief available to the Plaintiffs and ruled that they are not entitled to monetary damages. PERA is therefore proceeding at this point on defending the remaining claims. PERA and the State of Colorado have filed answers to the complaint.

On November 22, 2010, Plaintiffs filed their Motion for Partial Summary Judgment, seeking a determination as a matter of law that the Plaintiff's benefit, including the Annual Increase or COLA, cannot be altered by the General Assembly under any circumstances. Plaintiffs have requested that the Court find that that the proper legal standard for determining contract clause claims is set forth in the cases of *Police Pension and Relief Bd. of the City and County of Denver v. McPhail*, 139 Colo. 330 (1959) and *Police Pension and Relief Bd. of City and County of Denver v. Bills*, 148 Colo. 383, 38 (1961). Plaintiffs contend that under these cases, public pension benefits may not be reduced for any reason once an individual attains eligibility for his or her pension or retires and thus the Court must rule in their favor regardless of the facts related to PERA's funding condition.

PERA believes that the action taken by the General Assembly in S.B. 10-001 to reduce the COLA percentage was constitutional. S.B. 10-001 in its entirety and specifically, the reduction in the COLA percentage ensured PERA's long term sustainability and brought PERA to within a 30-year amortization period in order to pay off the unfunded liabilities. PERA believes that when benefits are reduced, the proper legal test is set forth in the more recent case of *In re Estate of DeWitt*, 54 P.3d 849 (Colo. 2002). In *DeWitt*, the Colorado Supreme Court extensively cited and followed United States Supreme Court precedent and held that there is essentially a three-pronged test to determine whether there is a violation of the Contract Clause. The first step in assessing an alleged Contract Clause violation is to determine whether there is a contractual relationship (to establish this component, a party must demonstrate that the contract gave him a vested right). Second, if there is a vested contract, the court must determine whether a change in the law impairs that contractual relationship and whether the impairment is substantial. To prove substantial impairment of a contractual relationship, a party must demonstrate that the law was not foreseeable and thus

disrupts the parties' expectations. Under *DeWitt*, the inquiry continues if a change in the law results in substantial impairment to a vested contract right. The third prong of the analysis is whether the reduction in the benefit was reasonable and necessary. In other words, even if SB 10-001 substantially impaired a contract right, it is constitutional if the Legislature's modification of the COLA formula was reasonable and necessary to address the legitimate public purpose of ensuring the long term sustainability of the PERA pension system.

A briefing schedule for the Motion for Summary Judgment has not yet been set by the Court, and will be set at the case management conference (not yet scheduled). Once the briefing schedule is set, PERA intends to file a cross-motion for summary judgment asserting that the Court should find that the proper constitutional test is set forth in *DeWitt* rather than *Bills* and *McPhail* and that based on the undisputed facts, the reduction in the COLA percentage by the General Assembly was constitutional as a matter of law.

- a. Have similar lawsuits been filed in other states, and if so, does PERA know their status?

PERA Response: There are three similar lawsuits about changes in pension plans going on in other states: Minnesota, South Dakota, and New Hampshire.

The Minnesota case is the most similar to the Colorado case. Based on declining funding levels for three large state pension plans, the Minnesota legislature readjusted the COLA that would be paid in the future to retirees. The COLA in the past had been linked to investment returns and later inflation, but in the future would be 1 percent to 2 percent until the pension plans reached 90 percent funding, at which point the COLA for different plans would be either 2.5 percent fixed or inflation with a 2.5 percent cap. Plaintiffs, like in Colorado, brought a lawsuit on behalf of some retirees, arguing that the state and federal Contracts Clauses prevent any change to the COLA paid to a retiree once they are receiving a benefit. In August 2010, the state and the retirement associations moved for summary judgment, arguing that the legislation was constitutional. At a September 2010 hearing, the court granted plaintiff three months of discovery and a deadline of January 2011 to rebrief the motion for summary judgment.

The South Dakota case challenges legislation passed in 2010 by South Dakota which readjusted the COLA going forward for retirees from 3.1 percent compounded to 2.1 percent, with a provision to return to 3.1 percent once the pension plan returns to 100 percent funding. Plaintiffs, like in Colorado, brought a lawsuit on behalf of some retirees, arguing that the state and federal Contracts prevents any change to the COLA paid to a retiree once they are receiving a benefit. The case was filed in June 2010, the defendants answered in July 2010, and discovery has commenced.

The New Hampshire case involves challenges to several changes in the benefits that will be paid to current workers when they retire. Most notably, the COLA was lowered. The case is different in that it applies to current workers instead of retirees, but the arguments are similar because plaintiffs allege that adjusting pension plan elements violates the state and federal Contracts Clause. In November 2010, the parties filed cross-motions for summary judgment.

6. How will PERA and/or the State be impacted if PERA loses the lawsuit?

PERA Response: The PERA Board began its efforts to address the long-term sustainability of the trust funds in September of 2008. This included an extensive review of the investment program, actuarial assumptions, as well as an analysis of the impact of changing each component of the benefit and contribution formula. This included an analysis of benefit changes to future hires, new hires, non-vested actives, non-vested inactives, vested inactives, vested actives, and existing benefit recipients. The PERA Board consulted with many experts and conducted public hearings around the state to solicit input from members, retirees, and the public before drafting their legislative recommendation for the General Assembly's consideration in 2010. In this analysis, one thing became clear: without a reduction in the fixed 3.5 percent COLA for the existing retirees, there was nothing that could be done to solve the problem. Without reducing the retiree COLA, PERA would run out of money before it would see sufficient savings from other benefit changes. Every viable solution delivered to the PERA Board by PERA's actuaries included a reduction in the COLA paid to existing retirees. PERA believes this deliberate and methodical approach to addressing the independent projections that the PERA trusts would run out of money establishes the foundation for constitutionality, along with the General Assembly's passage and the enactment of S.B. 10-001. S.B. 10-001 is a comprehensive package that in totality ensures PERA's long term sustainability. If the very significant piece of S.B. 10-001, the reduction of the COLA for existing retirees and those eligible to retire, is found to be unconstitutional, there is no way to solve the problem by a reduction in PERA's liabilities. The only way PERA could solve the problem if the COLA provisions were found to be unconstitutional would be a significant influx of capital into the system through an increase in the contribution burden.

11:50 – 12:00 CLOSING COMMENTS