ALTERNATIVES FOR ACTUARIALLY FUNDING THE PUBLIC EMPLOYEE RETIREMENT SYSTEMS

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Why this brief is important[1]

When the legislature considers legislation to fund required contribution shortfalls in the public employee retirement systems, legal questions are often raised about whether a particular revision might impair employee contract rights. The legislature's legal staff has produced several legal memorandums on these questions.[2] Based on the available case law, when determining whether a provision unconstitutionally impairs a contract, a court would likely ask the following questions:

(1) Have non-impairing alternatives been exhausted or at least seriously considered and found to be unreasonable or insufficient?

(2) Have less-impairing alternatives been exhausted or at least seriously considered and found to be unreasonable or insufficient?

(3) Is the questionable provision both "reasonable and necessary to serve an important public purpose"? [3]

We cannot know what a court will decide or war game all possible scenarios. Nevertheless, due diligence requires at least a listing and categorizing of the most obvious possible alternatives for addressing the funding shortfalls. Some of the alternatives listed are mutually exclusive. Other alternatives may be considered alone or in combination with others.

This brief makes no representation about whether a particular alternative is "good" or "bad". Nor does this brief list all conceivable alternatives. The alternatives listed are those that would likely not cut benefits below providing at least 50% of a person's final average salary after normal full service retirement.

This brief covers only the Teachers' Retirement System (TRS) and Public Employees' Retirement System (PERS). If requested, a similar brief could be done for the other public employee retirement systems with unfunded liabilities that do not amortize at all, or that do not amortize within the actuarially accepted standard of 30 years.

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[1] This is not a legal opinion of the Legislative Services Division. This is an informational brief only.

[2] David Niss, Legal Memorandums dated May 21, 2012, January 5, 2012, August 14, 2009, August 28, 2009 (Addendum), and February 27, 1998, Montana Legislative Services Division, (406) 444-3064, or visit www.leg.mt.us and contact staff for the State Administration and Veterans' Affairs Interim Committee.

[3] U.S. Trust Company of New York v. New Jersey, 431 U.S. 1 (1977)

Teachers' Retirement System (TRS)

I. Alternatives that do not raise contract impairment issues and that do not create a new member tier

A. Increase employer and/or state contributions
B. Provide flat dollar cash infusions

II. Alternatives that do not raise contract impairment issues but that would create a new member tier

A. Reduce benefits for new hires
(1) increase normal retirement age form 60 to 67 or enact a "rule of 90" [4]
(2) increase early retirement age from 50 to 55[5]
(3) increase the years of service for normal retirement from 25 to 30 years[6]
(4) extend from 3 to 5 years the period used for calculating highest average compensation (HAC)[7]
(5) increase vesting period to 7 years

B. Increase employee contributions for new hires only

III. Alternatives that may raise contract impairment issues (some may be less impairing than others)

A. Reduce benefits for all current and future members
(1) increase retirement eligibility age to 67 or enact "rule of 90"
(2) increase early retirement eligibility age to 55
(3) increase years of service for normal retirement to age 30
(4) increase vesting period to 7 years
(5) use 5 year period for calculating highest average compensation

B. Increase employee contributions on all current and future members[8]

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[4] A rule of 90 would means that if a person's years of service and years of age add up to 90, the person is eligible for normal retirement.

[5] The proposal by the TRS Board and Governor Schweitzer (LCsa06) includes this change.

[6] The proposal by the TRS Board and Governor Schweitzer (LCsa06) proposes a 30-year retirement but also a higher benefit multiplier for members with 30 or more years of service.

[7] The proposal by the TRS Board and Governor Schweitzer (LCsa06) includes this change.

[8] The proposal by the TRS Board and Governor Schweitzer (LCsa06) would increase employee contributions for current and future employees by 1% and authorized the TRS Board to impose an additional supplemental increase of 0.5% increments depending on the amortization schedule and funded ratio for the plan and only if a supplemental employer contribution is made as a match. If certain actuarial triggers are met, the supplemental contributions would be reduced.

Public Employees' Retirement System (PERS)

I. Non-impairing alternatives that do not create a new tier (or third class of members)[9]

A. Increase employer and/or state contributions[10]
B. Provide flat dollar cash infusions

II. Non-impairing alternatives that would create a 3rd tier

A. Further reduce benefits for new hires
(1) increase retirement eligibility age to 67 or enact "rule of 90"
(2) increase early retirement eligibility age to 55
(3) decrease benefit multiplier to 1.67% for all years of service
(4) increase vesting period to 7 years
(5) extend waiting period for GABA to 3 years

B. Further increase employee contributions for new hires[11]

III. Alternatives that affect current employees but that may avoid contract impairment issues

A. Calculate benefits for future years of service (i.e., service performed after the effective date of the change) using a reduced benefit multiplier (1.67%) that is the same as provided in TRS

IV. Alternatives that may raise contract impairment issues (some may be less impairing than others)

A. Reduce benefits for all current members and eliminate tiers
(1) increase retirement eligibility age to 67 or enact "rule of 90"
(2) increase early retirement eligibility age to 60
(3) decrease benefit multiplier to 1.66% for all years of service
(4) use 5 year period for HAC
(5) increase vesting period to 7 years
(6) extend waiting period for GABA to 3 years
(7) repeal GABA

B. Increase employee contributions

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[9] The legislature reduced benefits for new hires beginning July 1, 2011, so there are already two classes of active members in PERS.

[10] The PER Board proposal is to phase in an employer contribution increase that terminates when a certain actuarial trigger is met (i.e., when the system's unfunded liabilities amortize in less than 25 years).

[11] The legislature increased contributions for new hires by 1% beginning July 1, 2011.