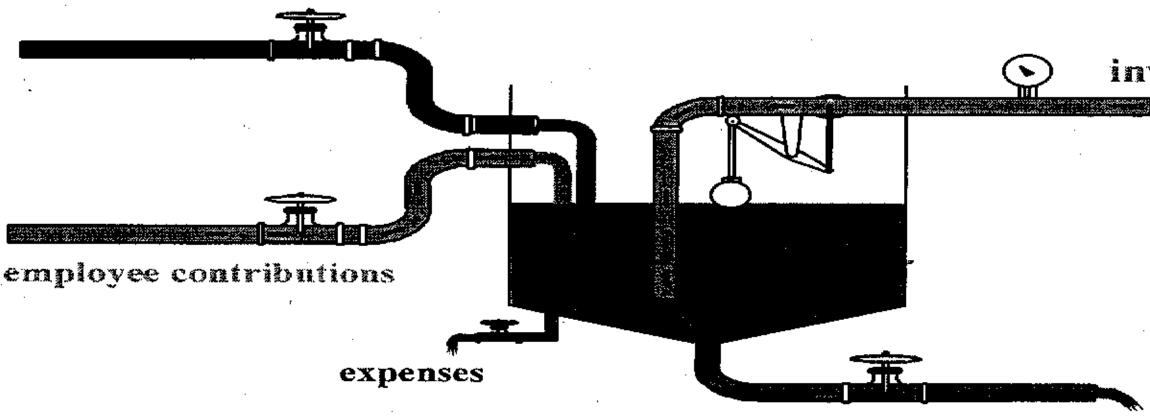
House & Senate State Administration Committees

Montana Legislature - 2005 Session

Teachers' Retirement System

RETIREMENT PLAN FUNDING PRINCIPLES



Historical Investment Returns*

Fiscal Year Ending	*Market Returns*	*Amortization Period*
June 30, 1996	*12.4%*	*27.20*
June 30, 1997	*19.4%*	
June 30, 1998	*16.6%*	*9.20*
June 30, 1999	*11.9%*	
June 30, 2000	*7.8%*	*15.10*
June 30, 2001	*(5.1)%*	
June 30, 2002	*(7.3)%*	*23.4*
June 30, 2003	*6.46%*	
June 30, 2004	*13.3%*	*> 30.0 years*

* Effective July 1, 2004 the annual investment rate of return is assumed to be 7.75% per year, compounded annually. Anything less is a loss, and will eventually increase the amortization period if not offset by future gains, contribution increase, or reduction in benefits.

Prepared by David L. Senn, Executive Director
Teachers' Retirement System

THE TEACHERS' RETIREMENT BOARD

- Governed by a six-member Board appointed by the Governor.
- Four members are appointed from the teaching profession,
    - One must be an active classroom teacher
    - One a retired member
- Two members are appointed as representatives of the public sector.
- The Board is responsible for the administration of the system and hires a staff of 16 to carry out these duties on a daily basis. The Board Of Investments (BOI) is responsible for investing all pension assets.

Board Members	**Term Expires**
TIM RYAN - Public Member Big Fork, MT Chair (Also a member of BOI)	July 1, 2009
SCOTT DUBBS - Active Member Lewistown, MT Vice Chair	July 1, 2008
Kari Peiffer - Active Classroom Teacher Kalispell, MT	July 1, 2007
BARBARA FOSTER - Retired Member Townsend, MT	July 1, 2006
MONA BILDEN - Active Member Miles City, MT	July 1, 2006
JAMES TURCOTTE - Public Member Helena, MT	July 1, 2005

TRS Actuarial Funding - The Montana Constitution, Article VIII, Section 15, requires that all public retirement systems be funded on an actuarially sound basis. Montana TRS, like most other public and private pension plans, has seen a significant decline since 2001 in the fair market value of its' pension assets. The Board's Funding Policy, adopted in May 2002, states that whenever the amortization period of the unfunded liabilities for two consecutive valuations are projected to exceed 30 years through the use of long term cash flow projections, and the Board cannot reasonably anticipate that the amortization period would decline without an increase in funding sources, it is the obligation of the Board to recommend to the legislature that funding be increased.

July 1, 2004 Actuarial Valuation - In anticipation of the need to increase contributions, and to verify the accuracy of the actuarial results, in March 2004, the Legislative Audit Division, and the Teachers' Retirement Board authorized an independent actuarial review of the Teachers Retirement System. The actuarial review included a full reproduction of the July 1, 2004 actuarial valuation results prepared by the TRS actuary, Milliman, and a review of recent experience studies, actuarial assumptions and methods used in the valuations. Mellon was selected to perform the actuarial review. Mellon concurred with the results of the July 1, 2004 actuarial valuation. Mellon's full report is available on the TRS Website: www.trs.mt.gov

The ultimate cost of a pension program over time equals the benefits paid and expenses incurred. The source of revenue used to pay for the cost is equal to the contributions from employers and employees to fund the program, plus investment return earned on contributions made through pre-funding the benefit payments.

The July 1, 2004 Actuarial Valuation concluded that an employer contribution rate increase of 2.87% would be required to maintain the actuarial funding of the Teachers' Retirement System as required by the Montana Constitution (estimated cost per year = $18 million). Alternatively, the required contribution rate increase could be phased in over the next two or three biennia, or lessened by lowering benefits for teachers and administrators who first become members of the system on or after July 1, 2005. If this rate increase were phased in over three biennia, a contribution rate increase of 1.20% would be required for the first two biennia, July 1, 2005 and again on July 1, 2007, with a third increase of 0.75% on July 1, 2009.

In addition, because the TRS smooth assets gains or losses over 5 years when the return on assets under performs the actuarial investment return assumption of 8.0% (7.75% starting July 1, 2004), at July 1, 2004, the TRS has $131 million in unrecognized asset losses. This unrecognized loss, if not offset by future gains, will cause the contributions needed to amortize the Unfunded Actuarial Accrued Liability in future valuations to increase; therefore, to stay financially sound in the future, the System will need either future gains that will return well over the new 7.75% assumption, or an increase in contributions rates.

TRS 2004 FINANCIAL HIGHLIGHTS

- Net investment income (fair value of investments plus investment income less investment expense) showed a gain of almost $281.7 million for fiscal year 2004 after a moderate gain in FY 2003, and having incurred losses in FY 2001 and FY 2002 as follows:
    - FY 2001 – ($119.1) million loss
    - FY 2002 – ($159.6) million loss
    - FY 2003 - $126.3 million gain
- Fiscal Year 2004 investment return 13.3%
- Total employee and employer contributions paid into TRS in FY 2004 totaled $107.9 million, while benefits paid exceeded $156.0 million.
- The TRS, as of June 30, 2004, had a total asset balance of $2.4 billion almost equal to the asset balance on July 1, 2001. Unfortunately, liabilities have continued to grow leaving the TRS significantly less funded today than it was on July 1, 2001.
- The actuarial present value of future benefits, as of the July 1, 2004 Actuarial Valuation, is $3.8 billion, compared to 3.4 billion on July 1, 2002.

FUNDING RETIREMENT BENEFITS

Retirement benefits are funded over time. The acceptable period of time to fund benefit improvements or what we commonly refer to as, "Unfunded Liabilities", is 30 years. One of the purposes of an actuarial valuation is to calculate the period of time required to amortize the system's unfunded liabilities. The goal is to spread the cost of funding benefits over the generation of taxpayers who will receive the benefit of the public service.

The TRS Actuary prepares a biannual Actuarial Valuation to determine the funded status of the system at the valuation date and the employer contributions that are necessary, along with investment returns and employee contributions, to fund the promised pension benefits. Each Year, investment gains or losses are smoothed over five years, i.e., only one fifth of each year's investment gain or loss is recognized in the actuarial valuation to smooth any materially impact on the funded status over more than just the past two years.