Pension Fund Fiscal Note 2015 Biennium

GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

Bill #	SB0333	**Title:**	Establish cash balance benefit tier in TRS and PERS for new hires
Primary Sponsor:	Arthun, Ron	**Status:**	As Amended

Retirement Systems Affected:

- ☑ Teachers
- ☑ Public Employees
- ☐ Highway Patrol
- ☐ Police
- ☐ Sheriffs
- ☐ Firefighters
- ☐ Volunteer Firefighters
- ☐ Game Wardens
- ☐ Judges

Check the box if "Yes".

- ☐ Has this legislation been reviewed by the legislative interim committee?
- ☑ Has the cost of this legislation been calculated by the system's actuary?
- ☐ Does this legislation include full funding for any benefit revisions?

TRS (Dollar Amounts in Thousands)	**July 1, 2012 Current System**	**July 1, 2012 With Changes**	**Increase/ (Decrease)**
Present Value of Actuarial Accrued Liability	$4,814,700	$4,814,700	$0
Present Value of Actuarial Assets	$2,852,000	$2,852,000	$0
Unfunded Actuarial Accrued Liability (UAAL)	$1,962,700	$1,962,700	$0
Amortization Period (years) of UAAL	Infinite	Infinite	0.00
Change in normal costs	9.65%	9.65%	0.00%

TRS	**FY 2013 July 1, 2012**	**FY 2014 July 1, 2013**	**FY 2015 July 1, 2014**	**FY 2016 July 1, 2015**	**FY 2017 July 1, 2016**
Employee Contribution Rate	7.15%	7.15%	7.15%	7.15%	7.15%
Employer Contribution Rate	7.47%	7.47%	7.47%	7.47%	7.47%
State Contribution Rate	2.49%	2.49%	2.49%	2.49%	2.49%
TOTAL Contribution Rate	17.11%	17.11%	17.11%	17.11%	17.11%

PERS (Dollar Amounts in Thousands)	July 1, 2012 Current System	July 1, 2012 With Changes	Increase/ (Decrease)
Present Value of Actuarial Accrued Liability	$5,661,281	$5,661,281	$0
Present Value of Actuarial Assets	$3,816,920	$3,816,920	$0
Unfunded Actuarial Accrued Liability (UAAL)	$1,844,361	$1,844,361	$0
Amortization Period (years) of UAAL	DNA	DNA	0.00
Change in normal costs	11.80%	11.80%	0.00%

PERS	FY 2013 July 1, 2012	FY 2014 July 1, 2013	FY 2015 July 1, 2014	FY 2016 July 1, 2015	FY 2017 July 1, 2016
Employee Contr Rate prior 7/1/2011	6.90%	6.90%	6.90%	6.90%	6.90%
Employee Contr Rate 7/1/2011	7.90%	7.90%	7.90%	7.90%	7.90%
State and MUS Contribution Rat	7.17%	7.17%	7.17%	7.17%	7.17%
State Contribution Rate	0.00%	0.00%	0.00%	0.00%	0.00%
Local Govt Contribution Rate	7.07%	7.07%	7.07%	7.07%	7.07%
State Contribution Rate	0.10%	0.10%	0.10%	0.10%	0.10%
School District Contribution Rat	6.80%	6.80%	6.80%	6.80%	6.80%
State Contribution Rate	0.37%	0.37%	0.37%	0.37%	0.37%
TOTAL Contribution Rate	15.07%	15.07%	15.07%	15.07%	15.07%

FISCAL SUMMARY

	FY 2014 Difference	FY 2015 Difference	FY 2016 Difference	FY 2017 Difference
Expenditures:				
General Fund	$0	$0	$0	$0
PERS - Pension Fund	$0	$20,000	$0	$0
TRS - Pension Fund	$0	$20,000	$0	$0
Revenue:				
General Fund	$0	$0	$0	$0
PERS - Pension Fund	$0	$0	$0	$0
TRS - Pension Fund	$0	$0	$0	$0
Net Impact-General Fund Balance:	$0	$0	$0	$0

Description of fiscal impact: SB 333 creates a new tier benefit structure for Teachers' Retirement System (TRS) and Public Employees' Retirement System (PERS) members hired on or after the effective date of the bill. New members will be enrolled in a cash balance plan, a hybrid defined benefit pension plan that maintains individual employee accounts. The employee's account earns a fixed rate of interest. Benefits will be based on the individual's account balance and a retirement system match subject to the number of years of service. The bill requires both retirement systems to seek a private letter ruling from the IRS concerning compliance with federal tax qualification provisions governing the retirement systems. Once this letter is received, both retirement systems estimate it will cost $20,000 in FY 2015 for IT changes in order to implement SB 333.

FISCAL ANALYSIS

Assumptions:

Teachers' Retirement System (TRS):

1. Contribution rates remain unchanged at: employee 7.15%, and employer (including the state supplemental) 9.96%.
2. The "***interest credit rate***" on tier two member account balances is 4.0% compounded annually.
3. ***Vesting*** - a member credited with at least five full years of membership service upon which contributions have been made has a right to a future retirement benefit.
4. ***Benefit Vesting Schedule*** – A vested tier two member has a right to a retirement system match of the member's account balance based upon the following schedule:

Years of Service	TRS Matching Percentage
Less than 5	0%
5	50%
6	60%
7	70%
8	80%
9	90%
10	100%

5. ***Non-Vested Termination*** – A non-vested member who terminates from service prior to vesting is entitled to receive a lump sum payment of the member's accumulated contribution account.
6. ***Vested Termination*** **–** A vested member who terminates is entitled to a lump sum payment of the member's accumulated contributions and the system match (the member's "vested cash balance amount"). A vested member who terminates and does not withdraw his accumulated contributions may, upon attaining age 60, elect an actuarial equivalent monthly annuity "retirement benefit". The member's accumulated contributions will continue to earn interest credits following separation from service until a distribution commence.
7. ***Eligibility for Service retirement*** – Age 60 and 5 years of service
8. ***Retirement Benefit*** **–** The member's accumulated contributions plus a retirement system match of the member's accumulated contributions, subject to the benefit vesting schedule, as an actuarial equivalent monthly annuity.
9. ***Death Benefits*** – In the event of death prior to retirement of a non-vested member, the designated beneficiary is entitled to receive a lump sum payment of the member's accumulated contributions. The designated beneficiary of a vested member who dies prior to retirement is entitled to receive a lump sum payment of the member's accumulated contributions plus a retirement system match of the member's accumulated contributions, subject to the benefit vesting schedule, disregarding the fact the member may not have been age 60 at the time of death.
10. ***Disability Benefits*** **–** A non-vested member who becomes disabled is entitled to receive a lump sum payment of the member's accumulated contributions. A vested member who becomes disabled is entitled to receive accumulated contributions plus a retirement system match of the member's accumulated contributions, subject to the benefit vesting schedule, as a lump sum distribution or an actuarial equivalent monthly annuity disregarding the fact the member may not have been age 60 at the time of death.
11. ***Guaranteed Annual Benefit Adjustment (GABA)*** - Tier two members are not eligible for GABAs.
12. ***Reemployment after retirement*** **–** If a tier two member is reemployed after receiving at least one benefit payment, the member's benefit payment must terminate. The member may redeposit amounts received as monthly benefits and receive proportional service credit for amounts redeposited. Any amount redeposited will not be subject to the system match at the time the member again terminates.
13. The expected normal cost rates for future employees compared to the current system are as follows:

	Current TRS - Tier 1	**Tier 2**
Employee	7.15%	7.15%
Employer	2.50%	0.07%
Total	9.65%	7.22%

14. The impact presented in the fiscal note assumes that this bill is the only amendment being considered. If other changes are also adopted, the fiscal impact associated with this bill could be different.
15. All calculations are based on the July 1, 2012 actuarial valuation.
16. The actuarial valuations and experience studies are available on the TRS website: http://www.trs.mt.gov/Board/ActuarialValuations/ActuarialValuations.asp
17. Once TRS has received a determination letter from the Internal Revenue Service certifying the new tier meets the qualification requires of the Internal Revenue Code, the cost of the IT system changes necessary to implement SB 333 will not exceed $20,000.

Public Employees' Retirement System (PERS):

18. **Member contribution rates** for active members would be set at 7.9%, the same as current levels for new members into PERS.
19. Employer contribution rates would continue at the same level of 7.17% and come from the same sources.
20. Members of the cash balance plan would have a graduated vesting of 5 to 10 years of membership service.

21. A member's vested cash balance account would be the member's accumulated contributions, plus a percentage of a matching amount paid by the system based upon years of membership service:

Years of Service	PERS Matching Percentage
Less than 5	0%
5	50%
6	60%
7	70%
8	80%
9	90%
10	100%

22. Retirement at age 60 with the cash balance account converted to an annuity paid for life, as under 19-3-1501, MCA, as currently offered.
23. Termination benefits are offered as follows:
    a. Non-vested members can receive a lump sum payment of the accumulated member contributions;
    b. Vested members can receive a lump sum payment of the vested cash balance amount. Vested members age 60 or older are eligible for a monthly annuity.
24. Death benefits are offered as follows:
    a. Non-vested members can receive a lump sum payment of the accumulated member contributions;
    b. Vested members can receive a lump sum payment of the vested cash balance amount.
25. Disability benefits are offered as follows:
    a. Non-vested members can receive a lump sum payment of the accumulated member contributions;
    b. Vested members can receive a lump sum payment of the vested cash balance amount, or an actuarial equivalent monthly benefit.
26. Return to work provisions are as follows:
    a. If a member receiving an annuity is reemployed in a covered position, the member's annuity payments must be terminated.
    b. The member may redeposit the benefit payment received but the redeposit is not eligible for the percentage match.
    c. The Board has rule making authority on how to treat individuals that return to work and retire a second time.
27. There would be no effect upon the June 30, 2012 actuarial valuation results since the new plan only would apply to future employees.
28. The effective date will occur after an IRS favorable determination letter has been received on the new plan. The actuary has assumed the provision to be in effect for employees hired on or after July 1, 2014.
29. The actuarial calculations are based upon the data, actuarial methods, and assumptions as were used in the Actuarial Valuations of the systems as of June 30, 2012.
30. Total payroll will increase at the assumed rate of 4%.
31. The fiscal impact presented by the actuary assumes that this bill is the only amendment being considered. If other changes are also adopted, the fiscal impact associated with this bill could be different.
32. There have been no adjustments for actuarial gains and losses or for changes in membership or financial data since the last valuation as of June 30, 2012.
33. The current new hire election rate is 93% choosing PERS-DB and 7% choosing PERS-DC.

34. The new hire election rate used for sensitivity analysis is 80% choosing PERS-DB and 20% choosing PERS-DC. It is likely that participation levels in the PERS-DC plan may be greater among tier three employees than seen under the current plan structure. If such an assumption were actually realized, the long term funding outlook would be worse for PERS-DB due to lower contributions coming into the system.
35. The interest rate for PERS Tier 1 & 2 members is the rate set by the Board based on the average of the Treasury note rate; the interest rate for the PERS Tier 3 plan members will receive a rate of 4.0% compounded annually.
36. The projections from the actuary are based upon a new member receiving a benefit that is an actuarial equivalent of the members vested cash balance account payable as an annuity for life and based on the same option tables that are currently used.
37. Tier 3 members do not receive a GABA.
38. The ARC shortfall is projected to decrease from 6.53% to 6.02% over the next 30 years based on the assumption that the election rates are the same as current. If the election rates increase, the ARC shortfall would be more.
39. The normal cost for the new cash balance plan is 9.51%. This compares to a blended normal cost rate of 11.80% for Tier 1 as of June 30, 2012 and to a rate of 9.92% for employees hired under Tier 2 that began July 1, 2011. The normal cost rate will be expected to decrease over time, but not to the same extent as under the current plan.
40. The funded ratio is projected to decrease from 67.4% to 56.3% over the next 30 years based on the assumption that the election rates are the same as current. If the election rates increase, the funded ratio would be lower.

ARC Shortfall	Current Plan	Current election rate (93% DB; 7% DC)	Election rate used for sensitivity analysis (80% DB; 20% DC)
2012 valuation	6.53%	6.53%	6.53%
5 year	5.48%	5.32%	7.03%
10 year	5.46%	5.14%	7.79%
20 year	5.97%	5.32%	9.77%
30 year	7.09%	6.02%	12.50%

Normal Cost	Current Plan	Current election rate (93% DB; 7% DC)	Election rate used for sensitivity analysis (80% DB; 20% DC)
2012 valuation	11.80%	11.80%	11.80%
5 year	11.03%	10.89%	10.99%
10 year	10.59%	10.35%	10.46%
20 year	10.14%	9.79%	9.85%
30 year	9.97%	9.57%	9.58%

Funded Ratio	Current Plan	Current election rate (93% DB; 7% DC)	Election rate used for sensitivity analysis (80% DB; 20% DC)
2012 valuation	67.4%	67.4%	67.4%
5 year		67.5%	67.2%
10 year		65.0%	63.8%
20 year		58.4%	52.5%
30 year		56.3%	42.6%

	FY 2014 Difference	FY 2015 Difference	FY 2016 Difference	FY 2017 Difference
Fiscal Impact:				
Expenditures:				
Operating Expenses - TRS	$0	$20,000	$0	$0
Operating Expenses - PERS	$0	$0	$0	$0
TOTAL Expenditures	$0	$20,000	$0	$0
Funding of Expenditures:				
TRS - Pension Fund	$0	$20,000	$0	$0
PERS - Pension Fund	$0	$20,000	$0	$0
TOTAL Funding of Exp.	$0	$40,000	$0	$0
Revenues:				
TRS - Pension Fund	$0	$0	$0	$0
PERS - Pension Fund	$0	$0	$0	$0
TOTAL Revenues	$0	$0	$0	$0
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):				
TRS - Pension Fund	$0	($20,000)	$0	$0
PERS - Pension Fund	$0	($20,000)	$0	$0

Long-Term Impacts:

1. The new benefit tier combined is expected to reduce the long term cost of the plan by 2.43%, which means that approximately 2.43% of new members' salaries will be available in the future to amortize unfunded liabilities of the current system. Projected reduction in unfunded liabilities are as follows:

Year	2014	2015	2016	2017
Projected Savings	$1,734,203	$3,303,968	$4,861,339	$6,424,740

2. Cash balance plans typically reduce benefit value for career employees as compared to traditional defined benefit plans. For example, under the current plan, a typical TRS member hired at age 30 will receive 50% of their final average earnings upon retirement after a 30 year career. Under SB 333, if the member were to annuitize their vested cash balance account they would only receive approximately 40% of their final salary after 30 years of service. In addition SB 333 does not provide a GABA, reducing benefit value under SB 333 even further when compared to the current plan.

Sponsor's Initials *Date* *Budget Director's Initials* *Date*