# Pension Fund Fiscal Note 2015 Biennium

GOVERNOR'S OFFICE OF
BUDGET AND PROGRAM PLANNING

| | | | |
|---|---|---|---|
| **Bill #** | SB0406 | **Title:** | Statutory referendum on pension reform, new hires to DC plan, not TRS or PERS |
| **Primary Sponsor:** | Brown, Dee | **Status:** | As Introduced |

**Retirement Systems Affected:**

- [x] Teachers
- [x] 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?
- [x] 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 | $5,083,500 | $268,800 |
| Present Value of Actuarial Assets | $2,852,000 | $2,852,000 | $0 |
| Unfunded Actuarial Accrued Liability (UAAL) | $1,962,700 | $2,231,500 | $268,800 |
| Amortization Period (years) of UAAL | Infinite | Infinite | 0.00 |
| Change in normal costs | 9.65% | 11.12% | 1.47% |

| **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% | 14.18% | 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 7/1/2011 | 7.90% | 7.90% | 7.90% | 7.90% | 7.90% |
| Employer Contribution Rate CP&Univ | 7.17% | 7.17% | 7.17% | 7.17% | 7.17% |
| Employer Contribution Rate CP&Univ-DC | 0.00% | 0.00% | 0.00% | 7.90% | 7.90% |
| Employer Contribution Rate LocGov | 7.07% | 7.07% | 7.07% | 7.07% | 7.07% |
| Employer Contribution Rage LocGov-DC | 0.00% | 0.00% | 0.00% | 7.90% | 7.90% |
| State Contribution Rate LocGov | 0.10% | 0.10% | 0.10% | 0.10% | 0.10% |
| Employer Contribution Rate SD | 6.80% | 6.80% | 6.80% | 6.80% | 6.80% |
| Employer Contribution Rate SD-DC | 0.00% | 0.00% | 0.00% | 7.90% | 7.90% |

# FISCAL SUMMARY

| | **FY 2014 Difference** | **FY 2015 Difference** | **FY 2016 Difference** | **FY 2017 Difference** |
|---|---|---|---|---|
| **Expenditures:** | | | | |
| General Fund | $0 | $0 | $180,066 | $564,509 |
| State Special Revenue | $0 | $0 | $97,973 | $247,316 |
| Federal Special Revenue | $0 | $0 | $67,563 | $176,652 |
| Proprietary | $0 | $0 | $38,845 | $97,971 |
| Other - MUS Tuition/Other | $0 | $0 | $57,198 | $144,261 |
| **Revenue:** | | | | |
| General Fund | $0 | $0 | $0 | $0 |
| Other - TRS DB | $0 | $0 | ($545,910) | ($5,200,282) |
| Other - PERS DB | $0 | $0 | ($3,842,000) | ($9,600,000) |
| **Net Impact-General Fund Balance:** | $0 | $0 | ($180,066) | ($564,509) |

**Description of fiscal impact:** Closing TRS and PERS DB pension plans and requiring that all new hires participate in a defined contribution type plan will reduce actuarially required contributions necessary to fund the defined benefit systems. SB 406, if approved by the voters in November 2014, will reduce the payroll base upon which contributions to the retirement systems are determined, resulting in a net decrease in dollars available to amortize the unfunded actuarial accrued liabilities.

# FISCAL ANALYSIS

**Assumptions:**

**Teachers Retirement System (TRS)**

1. SB 406 would require all teachers and administrators employed on or after October 1, 2015, into a position eligible to participate in TRS to become members of a statewide defined contribution (DC) plan.
2. The closure of the TRS is expected to impact the asset allocation and, therefore, the investment return over time. As the population of TRS transitions from the current population which consists of both active and retired members to one of only retired members, the cash flow characteristics of the system and therefore the liquidity needs in the future will change; therefore, we expect the asset allocation to slowly transition from one that is more heavily weighted in equity investments to one that has a higher proportion of total portfolio assets allocated to fixed income investments over time to meet the cash flow needs of the system. As a result, we have assumed the graded investment returns shown in the table below:

| Year | Assumed Rate of Return |
|---|---|
| **2012 - 2024** | 7.750% |
| **2025 – 2036** | 6.625% |
| **2037 and beyond** | 5.500% |

3. The amortization of the unfunded liability is currently determined as a level percentage of payroll. Since SB 406 closes TRS to new members, it is no longer appropriate to amortize the unfunded liability over increasing payroll. Therefore, the necessary contributions to fund the system have been calculated using a level dollar methodology.
4. The shortfall in the actuarial required contribution rate will increase from 4.89% to 12.42%.
5. Each DC plan member must contribute 7.9% of their compensation to the plan.
6. Each employer will contribute 7.9% of the member's compensation, of which, 4.1% will be allocated to the DC member's account, and 3.8% allocated to TRS to amortize the DB plan's unfunded liabilities.
7. Since teachers and administrators employed after October 1, 2015, will not be joining the current TRS plan, the payroll base reported to TRS will begin to decline immediately; therefore, fewer dollars will be available to pay down the unfunded actuarial accrued liabilities (UAAL). Under current TRS laws, 7.46% of covered payroll is available to amortize the UAAL. SB 406 will reduce contributions to TRS by allocating only 3.8% of the employer's DC contribution rate toward the amortization of the unfunded liabilities. The fiscal impact over the next four years covered in this fiscal note are as follows (for the purpose of this fiscal note we have assumed 20% of the anticipated new hire payroll for FY 2016 will be for teachers and administrators hired after the effective date of the act):

| | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|
| **New Hires Payroll** | $ NA | $ NA | $14,915,570 | $142,084,216 |
| **Current Law 7.46%** | $ NA | $ NA | $ 1,112,701 | $ 10,599,482 |
| **SB 206 – 3.8%** | $ NA | $ NA | $ 566,791 | $ 5,399,200 |
| **Funding Diverted** | $ NA | $ NA | $ 545,910 | $ 5,200,282 |

8. The DC plan proposed in SB 406 has an employer contribution rate of 7.9% compared to a long term employer normal cost rate of the current TRS plan which is 2.5%.
9. Even though the TRS DB plan is closed to all new hires after October 1, 2015, TRS covered employers will continue to submit monthly reports and contributions to TRS, and TRS will be responsible for submitting DC plan participants' wages and contributions to the statewide DC plan created under SB 406.
10. 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.

11. All calculations are based on the July 1, 2012 actuarial valuation. The actuarial valuations and experience studies are available on TRS' website:
    http://www.trs.mt.gov/Board/ActuarialValuations/ActuarialValuations.asp

**Public Employees' Retirement System (PERS):**

12. The current PERS-DBRP is closed to new participants.
13. The current PERS-DCRP is closed to new participants.
14. Employees hired after the effective date would no longer be eligible for the PERS-Defined Benefit Retirement Plan (PERS-DBRP) or the PERS-Defined Contribution Plan (PERS-DCRP).
15. Employees hired after the effective date would be members of the new defined contribution plan (New-DC).
16. Employer contributions increase:
    a. State and University employer from 7.17% to 7.9%
    b. Local governmental entities from 7.07% to 7.9%
    c. School district employers from 6.8% to 7.9%
17. Employers of active members in the New-DC would contribute a total of 7.9% of pay, allocated as follows:
    a. 4.1% of pay to the member's account
    b. 3.8% of pay to the PERS-DBRP subject to restriction.
18. The 3.8% of pay allocated to the PERS-DBRP must be used to pay the unfunded liabilities of PERS-DBRP associated with the closure of the plan to new members, and must be fixed based upon the actuarial valuation as of June 30, 2014. When the liability has been paid, the 3.8% will be contributed to the member's account.
19. The UAL will never be fully paid from the contributions made on behalf of members in the New-DC.
20. Vesting in employer accounts in the New-DC is full and immediate.
21. If enacted, the provisions of this bill will be submitted to the general electorate of the state in November 2014.
22. The actuary assumed the effective date for the new plan provisions would be October 1, 2015.
23. Since the changes in benefits affect future employees only, there would be no effect in the normal cost rates or in the actuarial liability as of June 30, 2012.
24. There would be a change in the UAL contribution rate due to the closing of the plan to new employees.
25. The total payroll will increase at the assumed rate of 4.0%.
26. All actuarial assumptions will be realized, including the investment return assumption of 7.75%.
27. The current amortization rate is based upon an "open" 30-year amortization of the UAL as a level percentage of future payroll assuming future annual payroll increases of 4%. By "open" amortization, it is meant that at each valuation date, a new 30-year period is established such that, in theory, the UAL would never be fully amortized. With the closing of the plan, there will no longer be an increasing payroll for this amortization, but rather a decreasing payroll. Therefore, the amortization method has been changed to a level dollar amortization.
28. Due to the closing of the plan, it would no longer be reasonable to use an open amortization method. Therefore, the amortization method has been changed to a fixed 30-year period starting on the effective date.
29. The fiscal impact 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.
30. 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.
31. Projections of future payroll for the New-DC are based upon projections of future PERS-DBRP payroll combined with estimates of future PERS-DCRP and ORP payroll based upon past experience of persons electing into those plans.

| | FY 2014 Difference | FY 2015 Difference | FY 2016 Difference | FY 2017 Difference |
|---|---|---|---|---|
| **Fiscal Impact:** | | | | |
| **Expenditures:** | | | | |
| ER Contributions TRS | $0 | $0 | $16,680 | $158,894 |
| ER Contributions PERS | $0 | $0 | $424,965 | $1,071,815 |
| **TOTAL Expenditures** | $0 | $0 | $441,645 | $1,230,709 |
| **Funding of Expenditures:** | | | | |
| General Fund (01) | $0 | $0 | $180,066 | $564,509 |
| State Special Revenue (02) | $0 | $0 | $97,973 | $247,316 |
| Federal Special Revenue (03) | $0 | $0 | $67,563 | $176,652 |
| Proprietary (06) | $0 | $0 | $38,845 | $97,971 |
| MUS Tuition/Other | $0 | $0 | $57,198 | $144,261 |
| Other - TRS DB | $0 | $0 | $0 | $0 |
| Other - PERS DB | $0 | $0 | $0 | $0 |
| **TOTAL Funding of Exp.** | $0 | $0 | $441,645 | $1,230,709 |
| **Revenues:** | | | | |
| General Fund (01) | $0 | $0 | $0 | $0 |
| State Special Revenue (02) | $0 | $0 | $0 | $0 |
| Federal Special Revenue (03) | $0 | $0 | $0 | $0 |
| Proprietary (06) | $0 | $0 | $0 | $0 |
| MUS Tuition/Other | $0 | $0 | $0 | $0 |
| Other - TRS DB | $0 | $0 | ($545,910) | ($5,200,282) |
| Other - PERS DB | $0 | $0 | ($3,842,000) | ($9,600,000) |
| **TOTAL Revenues** | $0 | $0 | ($4,387,910) | ($14,800,282) |
| **Net Impact to Fund Balance (Revenue minus Funding of Expenditures):** | | | | |
| General Fund (01) | $0 | $0 | ($180,066) | ($564,509) |
| State Special Revenue (02) | $0 | $0 | ($97,973) | ($247,316) |
| Federal Special Revenue (03) | $0 | $0 | ($67,563) | ($176,652) |
| Proprietary (06) | $0 | $0 | ($38,845) | ($97,971) |
| MUS Tuition/Other | $0 | $0 | ($57,198) | ($144,261) |
| Other - TRS DB | $0 | $0 | ($545,910) | ($5,200,282) |
| Other - PERS DB | $0 | $0 | ($3,842,000) | ($9,600,000) |

**Effect on Local Governments:**

**TRS**

1. The employer contribution on new entrants' compensation will increase from 7.47% to 7.9%. The long term impact of this rate increase on school districts and community colleges effective October 1, 2015, are as follows:

| SCHOOL DISTRICTS & COMM. COLLEGES | | | | | | |
|---|---|---|---|---|---|---|
| Fiscal Year | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** |
| Increased Employer Contributions | NA | NA | $ 45,547 | $ 433,877 | $ 638,392 | $ 843,697 |

2. It is not possible to estimate the costs of any changes that may be required by local governments to enhance their payroll systems.

**PERS**

3. The local government and school district employer contribution on new entrants' compensation will increase 7.9%. The long term impact of this rate increase on local governments and school districts effective October 1, 2015, are as follows:

| **Local Government & School Districts** | | | | | | |
|---|---|---|---|---|---|---|
| Fiscal Year | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** |
| Increased ER Contributions | | | | | | |
| Local Government | NA | NA | $ 271,825 | $ 685,576 | $ 963,900 | $ 1,249,500 |
| School Districts | NA | NA | $ 94,210 | $ 237,609 | $ 340,200 | $ 441,000 |

**Secretary of State (SOS)**

4. The total cost for ballots, printing, programming and other associated costs is estimated to be $830,046, which is divided by the average number of contests per ballot of 22 contests = $37,729.
5. In 2012 the cost to counties for programming and printing legislative referenda was approximately $113,200 (3 x $37,729).

**<u>Long-Term Impacts:</u>**

1. Closing TRS to new entrants does not immediately reduce the annual cost of the system. The amortization period of a closed TRS is still infinite. As a result, the legislature will need to appropriate significant additional revenue annually in order to amortize the unfunded liability within 30 years.
2. The current PERS-DBRP funded status deteriorates in the long-term.
3. By 2032, the PERS-DBRP unfunded actuarial liability (UAL) increases to $5.21B.
4. The PERS-DBRP funded status will deteriorate over the long-term.
5. The 3.8% allocated to the PERS-DBRP will never pay off the UAL.
6. Other funding sources would be required to meet the benefits promised to continuing members in the closed PERS-DBRP.
7. With the closed plan, at some point in the future, the asset allocation will become more conservative to meet the increasing cash flow requirements of the PERS-DBRP. Therefore, the assumed rate of future investment return will need to be lowered, impacting the long term funding even more.

**<u>Technical Notes:</u>**

1. There are technical drafting concerns that need to be addressed in order for the retirement plan to maintain its "qualified plan" status as set by the Internal Revenue Code.
2. Section 9 provides that a DC member who has terminated service and attained at least age 60 may elect to have their DC account balance converted to a retirement annuity and that the retirement benefit would be suspended if the member returns to active employment. It is not clear if the annuity contract will be purchased through a third party, or will be done in some manner by the retirement system. If the annuity is purchased from a third party, it likely will not be possible to suspend the benefit payments if the retiree returns to active employment in either a TRS or PERS covered position, as would be required under section 9(2) of SB 406.

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