

# TEACHERS' RETIREMENT BOARD LEGISLATIVE CONCEPTS MAY 2010

## TRS BOARD 2011 LEGISLATIVE CONCEPTS

The legislative concepts submitted to the Governor's Budget Office on April 15, 2010, by the Teachers' Retirement System (TRS) Board included three proposals. The first priority is to actuarially fund the TRS. The amount of funding required will depend on how the markets perform between now and June 30, 2010, and the new plan design recommend by SAVA, which could include some or all of the following proposals. The second priority is a housekeeping proposal, and third is a proposal to increase the University System's supplemental contribution rate to comply with the statutory requirement to amortize the unfunded liabilities associated with creation of the ORP by July 1, 2033.

### 1. Funding Proposals

**Increase Employer Contribution Rate** – Based upon the July 1, 2009 actuarial valuation of the retirement system and the revised actuarial assumptions adopted following the recently completed experience study, TRS' actuary estimates a contribution rate increase of 2.54% is required, effective July 1, 2011, to amortize the unfunded liabilities over 30 years. A 2.54% increase effective July 1, 2011, would generate approximately \$40.4 million in additional employer contributions over the next biennium. In order to reduce the immediate impact of the proposed employer rate increases, the TRS Board is recommending spreading the increase in the employer contribution rate over the next 4-6 years. The amount of the increase required in each year will depend upon the number of years selected for full implementation of the rate increase. For example, a 0.5% increase would generate approximately \$4.0 million per year in additional employer contributions.

Of course, the actual contribution rate increase required to amortize the unfunded liabilities over 30 years will depend on the investment returns through June 30, 2010, and the plan design changes and funding enhancements adopted by the SAVA Committee and implemented by the Legislature. For example, the recommended contribution rate increase of 2.54% effective July 1, 2011, could be reduced if a less expensive plan design were adopted by the legislature for new hires.

**Working Retirees** – Current law limits retirees returning to work to part-time employment that pays no more than one-third of their Average Final Compensation (AFC). Part-time employment is defined as less than 180 days (1260 hours based on 7 hour days) in a fiscal year; at least 140 hours per month in at least 9 months (1260 hours) in the fiscal year; or less than full time based on the school district's alternate school year schedule that meets accreditation standards.

In the past there have been attempts, following the retirement of a TRS member, to divide a TRS-reportable position into two or three positions, of which only one is claimed to be TRS-reportable, and then rehire the recently retired member for all the

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newly created positions. Under this concept, if a TRS retiree is re-employed in a part-time TRS-reportable position by an employer and is concurrently employed by the same employer in a position that, on its own, would not be a TRS-reportable position, the positions and compensation would be deemed to be combined as a single TRS-reportable position. Such provision will prevent the splitting of job functions and/or the creation of new positions as a means of paying retirees more than the one-third limit by "employing" them in positions that would appear not to be reportable to TRS in order to end-run the earnings limitations. There may need to be some means of excepting the hiring of TRS retirees concurrently under the 1/3 earnings limitation and in a non-TRS-reportable position that has been a long-standing position with the employer.

The substantive limitation under current law is the amount a working retiree may earn. Tracking the number of hours or days a retiree works each month has proven to be very difficult, and for salaried employee, i.e., part-time administrators, almost impossible. For this reason, the Board also recommends the statute be amended to remove the consideration for part-time vs. full-time employment for working retirees, and focus only on the earnings limitation as the determining factor in returning a working retiree to active member status.

**10% Cap Exceptions** - Repeal all or most exceptions to the 10% cap. Under current law, § 19-20-715, MCA, earned compensation used in the calculation of AFC for a retiring TRS member is capped at 110% of the prior year's compensation, with exceptions allowed to be authorized by rule of the TRS Board. This kind of provision is implemented by retirement systems to prevent unreasonable increases in compensation made in the final years of employment (the years typically included in the calculation of AFC) that have the effect of significantly increasing the retiring member's retirement benefit without having provided actuarial funding to the retirement system for those increased benefits.

In recent years, the number of retirees taking advantage of exceptions to the 10% cap has continued to grow. While the impact to the retirement system with respect to any specific retiree taking advantage of an exception is small, in aggregate, the exceptions will cost the retirement system millions of dollars over the lifetime all retirees taking advantage of the exceptions. There may be a need to continue to allow the exception for increases resulting from normal movement on a collectively bargained salary matrix, or part-time employment. In addition, other existing exceptions could be considered as the TRS Board continues to discuss this proposal with interested parties.

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Since the cap was enacted in 1989, the following exceptions have been approved.

<u>Code</u>	<u>Reason for Exception</u>
1.	Collective bargaining agreement
2.	A change or an adjustment in a salary schedule covering a certifiable group of employees not covered under a collective bargaining agreement. The employer must certify the group of employees affected by the change or adjustment in the salary schedule, the increase received by each employee, and the methodology for determining the increases
3.	Compensation received for summer employment, provided summer compensation does not exceed one-ninth of the academic year contract for each full month or prorated for each portion of a month employed during the summer
4.	Change of employer
5.	Re-employment for a period of not less than one year following a break in service
6.	A promotion to an existing permanent position with the same employer. The assignment of temporary duties or a new job added to existing duties, an acting or interim appointment, a change in classification or title, or an increase in compensation received would not qualify as a promotion
7.	The combination of salary from multiple employers that when reviewed separately does not exceed 10%
8.	Annualized part time wages
9.	Excess earnings less than \$100

Between July 1990 and April 2010, 747 exceptions to the 10% cap were authorized, with an average benefit increase of \$44.04 per month. The actuarial cost over this period of time of the benefit increases has been approximately \$4.8 million.

If all or most exceptions were eliminated, any amounts in excess of the 10% cap would still be included in average final compensation under termination pay option 2, which provides for a minimal benefit increase funded by the normal employee and employer contributions already collected. For example: A member with 25 years of service and excess earnings of \$10,000 that were exempt from the cap, would receive a benefit increase of \$115.74 per month, with no additional funding paid into TRS. If there were no exceptions and the excess is included under termination pay option 2, the benefit increase would only be \$13.51 per month.

TRS is also considering whether reducing the impact to retiring members by offsetting the "loss" of the 10% cap exceptions by increasing the cap to 12% or 15% might be feasible.

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**Full Actuarial Reduction for Early Retirement** – Under current law, §19-20-802, MCA, members retiring with less than 25 years of service between the ages of 50 and 60 receive a reduced “early” retirement benefit. The reduction is 0.5% for the first 60 months early and 0.3% for each additional month. The maximum reduction is 48.0%. The reduction is based on the number of months the member is short of 25 years of service, or age 60, whichever is less. These reduction factors are not actuarial reduction factors, but standardized reduction factors that result in the retirement system "subsidizing" the retirement benefits of many early retirees. In other words, by application of these standardized reduction factors, early retirees will earn more in early retirement benefits over their anticipated lifetimes than the actuarial value of their retirement benefits would have been if they had retired at normal retirement age.

Our actuaries recommend that early retirement reductions be made by application of true actuarial factors such that the benefit paid to an early retiree is actuarially equivalent to the benefit that would have been paid to the retiree at normal retirement age. Application of true actuarial factors would end the "subsidizing" of early retirement. Actuarially equivalent factors generally start out at 6-8% per year and grade down to 3-5% per year over time. There should be no maximum reduction. The actual factors should be based on the actuarial assumptions based on the most recent experience study. The Board proposes replacing the current statutory reduction factors with actuarial factors periodically reviewed and approved by the Board.

**Effective July 1, 2011, Charge the Actuarial Interest Rate on all Buy Backs --**

For members hired prior to July 1, 1989, current law limits the rate of interest charged on service purchase agreements for the following types of service to the same rate credited to the member’s account. Members hired after July 1, 1989, are required to pay the full actuarial cost for most service purchased. With the rate credited to member’s accounts currently at only 1.0% and 0.25% effective July 1, 2010, these purchases are underfunded. Therefore, we are proposing to change the law effective July 1, 2011, to charge the actuarial assumed rate, currently 7.75% on all service purchase agreements.

The following service types would be affected only for members hired before July 1, 1989:

<b>Description</b>	<b>Counts</b>	<b>Balance</b>
Leave Time	27	\$138,699.22
Out of State Teaching	33	\$258,424.65
Private Teaching	5	\$70,166.1
Mt. Extension Service	1	\$12,644.81

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Interest charged on the following types is limited to the rate credited to members' accounts regardless of the date of hire:

Description	Counts	Balance
Legislative Time	1	\$460.83
Military Service	8	\$35,707.23
Redeposit Previous Service	64	\$524,394.93

## 2. TRS Housekeeping

A housekeeping proposal will be necessary to address any possible IRS rule changes or changes related to our request for a determination letter, clarifications to the amendments to the Family Law Order provisions, definitions, and other statutory clarifications. For example:

- Clarify the definition of "retired member" and add a definition of "retirement," each of which would mean that a member has terminated all employment covered under TRS and has received and accepted a retirement benefit.
- Clarify the definitions of full-time and part-time.
- Clean up confusion regarding ability to change designated beneficiaries and use the term "joint annuitant" in reference to the optional retirement benefits, i.e., options A, B, & C.
- Add a provision requiring family law orders to be drafted using document forms and/or provisions as determined by TRS and set forth in administrative rule.
- Move substance of definition of "earned compensation" to statutes and out of definition (and may expressly allow for administrative rules).
- Include specific employer reporting requirements and possible penalties for failure to properly report – including liability for overpaid benefits and interest.
- Expand recovery and debt collection capabilities to provide greater options for current judgments and recoveries as opposed to actuarial adjustment of benefits – clarify that recovery to the system has priority over payment of benefits to the member or any beneficiary thereof.
- TRS/PERS data sharing requirements.

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### **3. Increase University Supplemental Contribution Rate**

Section 19-20-621, MCA, requires each employer within the University System with employees participating in the Optional Retirement Program (ORP) to make a supplemental employer contribution to the teachers' retirement system sufficient to amortize the past service liability of their employees participating in TRS by July 1, 2033. The law also requires the TRS Board to periodically review the University System supplemental employer contribution rate and recommend adjustments to the legislature as needed to maintain the target amortization date of July 1, 2033. TRS' actuary provided a preliminary report of the ORP supplemental contribution requirements, and TRS included the anticipated required increase with the legislative concepts submitted to the budget office.

The preliminary valuation of the ORP supplemental contribution rate indicates a required supplemental contribution rate, effective July 1, 2010, of 8.52% of ORP member salaries. This represents an increase of 3.80% from the current rate of 4.72%, or an increase of approximately \$7.7 million per year. This valuation is based on July 1, 2009, data and will be updated and finalized once the July 1, 2010, valuation is completed. The final report will also reflect any investment gains or losses for FY 2010, and the changes in the actuarial assumptions adopted by the TRS Board in May 2010.