Montana Public Employees' Retirement Board – Background

The Board

The Montana Public Employees' Retirement Board (Board) consists of seven members, appointed by the Governor and confirmed by the Senate. Appointments are for 5-year staggered terms. §2-15-1009, MCA

Three Active Members
John Nielsen (President) – Active Member (DOT in PERS, Glendive)
Terrence Smith (Vice President) –Active Member, PERS-DCRP (Bozeman)
Scott Moore – Active Member (Firefighter in FURS, Butte)

One Retired Member
Darcy Halpin – PERS Retired Member (Belgrade)

Three Members at Large, one with investment experience*
Diana Porter – Member at Large (Butte)
Timm Twordoski – Member at Large (AFSCME Executive Director, Helena)

Pat McKittrick – Investment Experience (Attorney, Great Falls)

*Experience in investment management, counseling or financial planning or other similar experience.

Board Mission Statement

The Montana Public Employees' Retirement Board will fiduciarily administer its retirement plans and trust funds, acting in the best interest of the members and beneficiaries.

STATE ADMINISTRATION/VETERANS' AFFAIRS
JUNE 24, 2011 MEETING
Exhibit 2

Fiduciary Duty

The Public Employees' Retirement Board has a duty to conform to "fundamental fiduciary duties of loyalty and impartiality".

A fiduciary shall discharge duties with respect to a retirement system:

- Solely in the interest of the participants and beneficiaries.
- For the exclusive purpose of providing benefits to participants and beneficiaries.
- Impartially, taking into account any differing interests of participants and beneficiaries.
- Adherence to the duty of loyalty, prohibiting all transactions posing conflicts of interest.

Implementing fiduciary duty includes:

- Maintaining actuarially sound systems.
  Article VIII, Section 15 of the Constitution and §19-2-409, MCA
- Employing an accredited actuary to value the systems. §19-2-405 (1), MCA
- Ensuring the plans are IRS "qualified" governmental plans.
- Maintaining a stable retirement foundation for our members. §19-2-403 (9), MCA
- Upholding member contract rights. §19-2-502(2), MCA
- Proposing legislation for all of the above. §19-2-403 (9), MCA

MPERA

The Montana Public Employee Retirement Administration consists of 45 management and administrative staff to the Board.

- MPERA does not invest the pension trust funds. That is done by the Montana Board of Investments. We have one Board member who also sits on the Board of Investments – Patrick McKittrick. Clifford Sheets, Chief Investment Officer presents regularly to the PERB.
- MPERA does administer the money in the pension trust from a public employee's first payday until they or their beneficiary receive their last guaranteed benefit payment.

- MPERA administration is inexpensive. Administrative costs for FY 2010 were $4M for the management of all trusts – combined assets greater than $4.5B.
- MPERA collects contributions each payday for 44,700 active members from 550+ state and local government employers.
- MPERA pays benefits to over 20,800 retirees and dependents each month.

The Retirement Plans

These core services are provided to members and employers covered by 10 distinct retirement plans (state and local government), each of which are qualified under federal tax law to defer income taxes until a benefit is received. [Reference *Green Sheets*]

Public Employees' Retirement System (PERS)
– Defined Benefit Retirement Plan (DBRP)
– Defined Contribution Retirement Plan (DCRP)
Judges' Retirement System (JRS)
Highway Patrol Officers' Retirement System (HPORS)
Sheriffs' Retirement System (SRS)
Game Wardens' and Peace Officers' Retirement System (GWPORS)
Municipal Police Officers' Retirement System (MPORS)
Firefighters' Unified Retirement System (FURS)
Volunteer Firefighters' Compensation Act (VFCA)
State Deferred Compensation (457) Plan

All plans are defined benefit plans except the PERS-DCRP and the 457-Deferred Compensation Plan.

The PERS is the largest plan and provides coverage to employees of state agencies, counties, cities, local governments, university and school districts (non-professional staff).

Approximately 6% of the PERS members have elected the DCRP (2,018 as of June 30, 2010). PERS active members are generally older (average age at hire date is 39) and less likely to take risks.

In the DCRP, the *contribution* is defined. The member is responsible to choose their own investments from a list of options. The benefit is the account balance (employee contributions, a portion of employer contributions, plus and earnings/losses).

In the DBRP the *benefit* is defined based on a formula:

Highest Average Compensation x Years of Service x Factor

In the Defined Benefit plans, pension trust funds are well-funded when there is enough money in reserve to meet all expected future obligations to participants. The Board's funding objective is to meet long-term benefit promises through contributions that remain approximately level as a percentage of member payrolls.

The Deferred Compensation Plan is a voluntary retirement plan available to all state and university employees and any local government contracting with the Board. Its design is similar to a defined contribution plan.

Requirement to be Actuarially Funded

- The Montana Constitution Article VIII, Section 15
- State Law §19-2-409, MCA and
- The Governmental Accounting Standards Statement #25

All require that the retirement systems be funded on an actuarially sound basis.

What does it mean to be actuarially sound?

> ***Plans to be funded on actuarially sound basis -- definition.*** *As required by Article VIII, section 15, of the Montana constitution, each system must be funded on an actuarially sound basis. For purposes of this section, "actuarially sound basis" means that contributions to each retirement plan must be sufficient to pay the full actuarial cost of the plan. For a defined benefit plan, the full actuarial cost includes both the normal cost of providing benefits as they accrue in the future and the cost of amortizing unfunded liabilities over a scheduled period of no more than 30 years. For the defined*

contribution plan, the full actuarial cost is the contribution defined by law that is payable to an account on behalf of the member. §19-2-409, MCA

Based on the report of our actuary for June 30, 2010, five of the eight defined benefit plans were adequately funded with the actuarial liabilities amortizing within the 30 year limit. Three were not – PERS, SRS and GWPORS.

Investments Play a Critical Role in Retirement Funding

- Investments are the largest source of funding
  - In PERS ER and EE contributions make-up 25%.
  - Almost 75% of income relies on investment returns.
- Investment returns along with employer contributions fund the benefits
- Investments have a powerful, far reaching effect
- Investments are volatile
- Investments need time grow – over the career-life of the employee

The devastating losses in FY 2008 and 2009 eroded retirement system assets across the nation. Markets are improving: FY 2010 rate of return – 12.87%; FY 2011 rate of return for all plans as of May 31, 2011 – 22.73%.

Because of actuarial smoothing – a process that spreads gains and losses over a four year period; we must still account for a portion of the FY 2008 and 2009 losses. We will also be recognizing portions of the FY 2010 and FY 2011 gains. The actuarial valuations will not be received until late September or early October.

Employ an Accredited Actuary for Annual Valuations

The board shall retain a competent actuary who is an enrolled member of the American academy of actuaries and who is familiar with public systems of pensions. The actuary is the technical adviser of the board on matters regarding the operation of the retirement systems. §19-2-405 (1) MCA

The Board's actuary is Cherion.

Maintain Sustainable Retirements

Montana Code Annotated also requires the Board to maintain a stable standard of living for its members:

> *The board shall review the sufficiency of benefits paid by the retirement system or plan and recommend to the legislature those changes in benefits in a defined benefit plan or in contributions under the defined contribution plan that may be necessary for members and their beneficiaries to maintain a stable standard of living.* §19-2-403 (9), MCA

Uphold Member Contract Rights

Current members and retirees have a contract right to the benefits in statue on their date of hire.

> *Benefits and refunds to eligible recipients are payable pursuant to a contract as contained in statute. The contract is entered into on the first day of a member's covered employment and may be enhanced by the legislature.* §19-2-502(2), MCA

Therefore, prospective changes that reduce retirement benefits are limited to new hires. New hires do not create unfunded liability; in fact, retirement systems depend on some employer contributions of future members' salaries to pay for the existing liability.

Due to the nature of retirement plans, it will take a generation to see the results of any changes to retirement plan design on the actuarial unfunded liability.

It is the Board's policy to not support benefit enhancements that do not include a funding mechanism. It is also the Board's policy to maintain a sustainable benefit level to our members. Retirement plans are a part of the benefit package provided by employers. Promoting a good retirement plan helps with:

- Recruitment
- Retention
- Rewards Loyal Service and

- Makes Retirement Possible.

2011 Legislation

After working with our Actuary, the Board requested four pieces of legislation to address the unfunded liabilities in the PERS, SRS and GWPORS. These plan design changes reflected trends in other states and focus on long-term plan sustainability.

HB 135 – SRS Funding & HB 134 – GWPORS Funding

These bill proposals were the same – Increase the HAC from 36 months to 60 months (for new hires after July 1st) and increase employer contributions by 1% each year of the biennium. The employer increase was eliminated before the bills were passed. Increasing the HAC tackles perceived and real attempts to "spike" compensation in the years before retirement.

HB 122 – PERS Funding

In addition to the proposals in HB 134 & 135, this bill increased the retirement age from 60 to 65, phased in the retirement factor*, increased contributions for new hires by 1%, and increased employer contributions by 1% each year of the biennium. Again, the employer increase was eliminated prior to passage of the bill. Increasing the retirement age reflects longer longevity and working careers. Phasing in the calculator rewards career employees.

*The retirement factor used to calculate the retirement benefit for all new hires is:

=>1.5% per year if service is less than 10 years,

=>1.785% per year is service is greater than or equal to 10 years but less than 30 years,

=>2% per year if service is greater than or equal to 30 years.

HB 85 – Working Retiree Bill

Working retirees are a strain on the retirement systems, this bill request proposed receiving employer contributions on working retiree compensation. This bill was tabled in committee.

Summary

The Board appreciates the support and action of the legislature this past session. The Board understands the legislature's position for eliminating the funding in the Board's bills during in these tight economic times. We will be reviewing the actuarial results before making any proposals to SAVA.

In conclusion, I would like to leave you with these facts:

- Public employees share in the financing of their pensions.
- Public pension plans remain a small portion of state and local government budgets.
- Retirement benefits assist with recruitment and retention of qualified employees.
- Public pension plans provide financial security in retirement offsetting the need for public assistance.
- The legislature has taken steps to address long-term plan sustainability.
- Long-term investment returns continue to exceed expectations.
- Pension dollars help the economy at every level. (Reference *Pensions Benefit Montana Economy*).

We would like to continue to work together with SAVA and the legislature to provide sustainable, equitable retirement plans for all.