

PERFORMANCE AUDIT

Analysis of Retirement Benefit Inflation in Montana's State Pension Systems

Montana Public Employee Retirement Administration
Teachers' Retirement System

DECEMBER 2010

10P-10

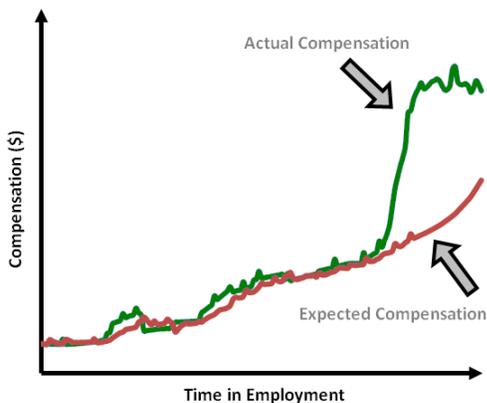
REPORT SUMMARY

Limited examples of benefit inflation can occur within Montana's state-administered pension systems; if the legislature wishes to address benefit inflation, statutory changes are necessary.

Context

Public sector pensions have been attracting significant attention across the United States in recent years. Due to economic factors such as investment volatility, many states, including Montana, have struggled to adequately fund retirement benefits.

One of the risks associated with defined benefit plans is benefit inflation. Benefits in these plans are generally set as a percentage of the employee's highest average compensation. When increases in compensation occur late in a member's career, they inflate the member's retirement benefit without a corresponding increase in contributions to the system. Our analysis indicates that benefit inflation is a



Example of benefit inflation - actual compensation increases at a fast rate in final years of employment as compared with expected compensation

relatively rare practice. It can represent a significant financial benefit to an individual member but unlikely impacts the solvency of Montana's retirement systems. When it occurs, it creates a negative public perception of system operations.

Results

This audit determined that benefit inflation can and does occur within Montana. Retirees have been legally able to increase pension benefits by engaging in several types of actions that coincide with the period used to calculate pension benefits:

- ▶ Working significant amounts of overtime
- ▶ Receiving bonuses or other discretionary payments
- ▶ Accruing legislative service time prior to other full time public service
- ▶ Earning compensation from dual employment
- ▶ Obtaining other significant, late-career compensation increases
- ▶ Seeking exemptions to existing compensation growth limits

Because defined benefit systems guarantee a pension benefit for life, even small increases to a pension benefit can create a significant financial impact. For example, this report discusses eight examples of the practices listed above. We estimate that in those eight cases the retirees cumulatively increased their lifetime pension payments by approximately \$1.75 million.

Despite the work of both agencies which administer pension benefits in the state, we determined that retirement benefits are not always equitable or based on normal compensation and service history. Agency controls to detect retirement benefit inflation could be strengthened, but other aspects of the retirement benefit calculation process can only be addressed through changes in statute.

This report includes four recommendations. Two recommendations address legislative consideration of the conditions which may allow retirement benefit

inflation to occur. Two are addressed to the administrative agencies and concern improvements related to the efficient collection and retention of member data.

Recommendation Concurrence	
Concur	3
Partially Concur	0
Do Not Concur	0

Source: Agency audit responses included in final report.

For a complete copy of the report or for further information, contact the Legislative Audit Division at 406-444-3122; e-mail to lad@mt.gov; or check the website at <http://leg.mt.gov/audit>. Report Fraud, Waste, and Abuse to the Legislative Auditor's FRAUD HOTLINE Call toll-free 1-800-222-4446, or e-mail lad@mt.gov.