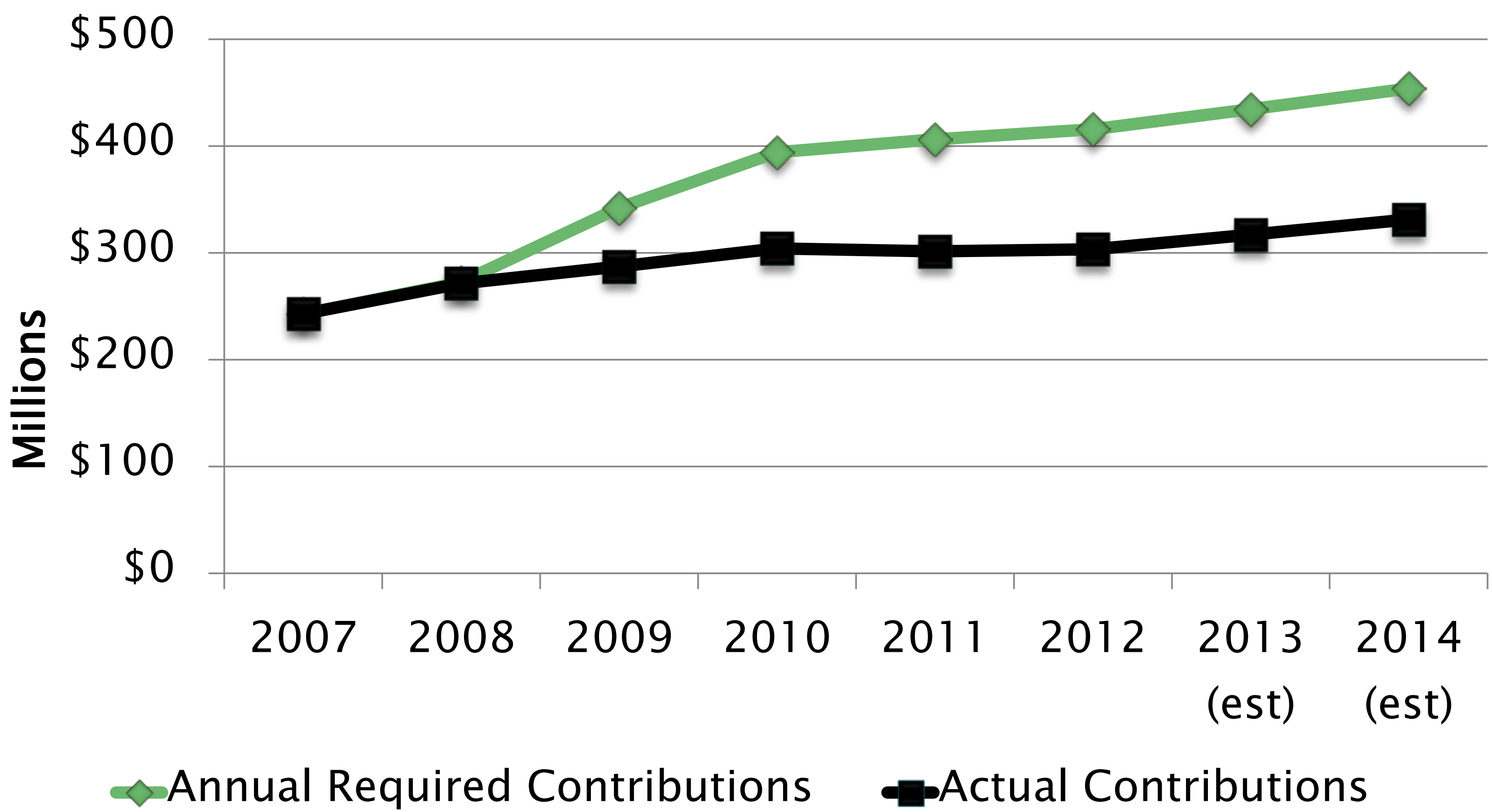
2015 Pension Funding and Finance

Legislative Fiscal Division

LFD
Montana Legislative Fiscal Division

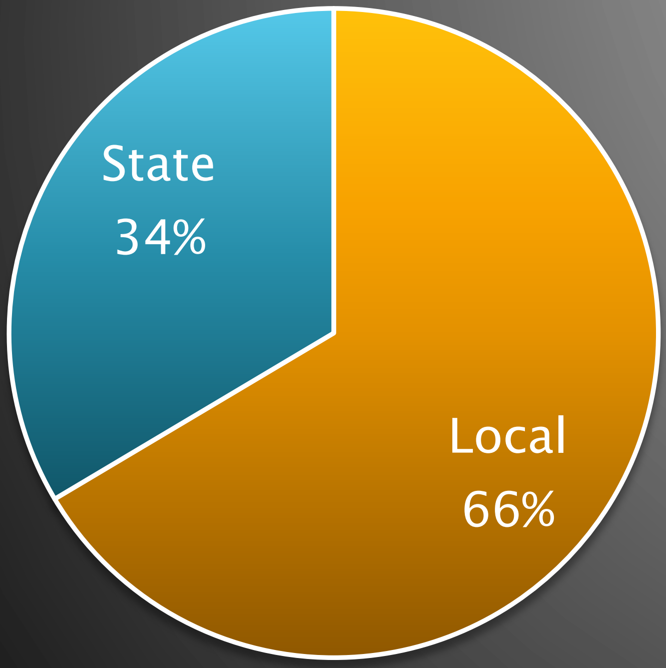
www.leg.mt.gov/css/fiscal

Pensions: ARC Funding Shortfall

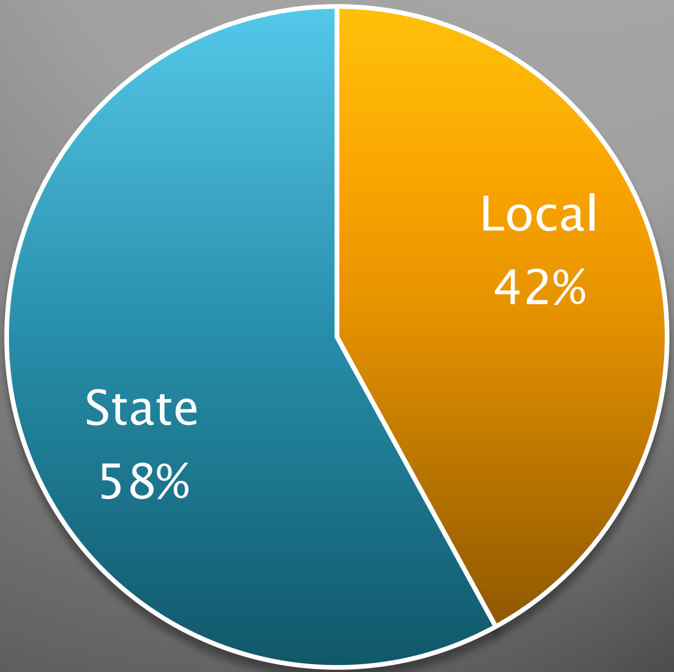


Pension Systems FY 2012

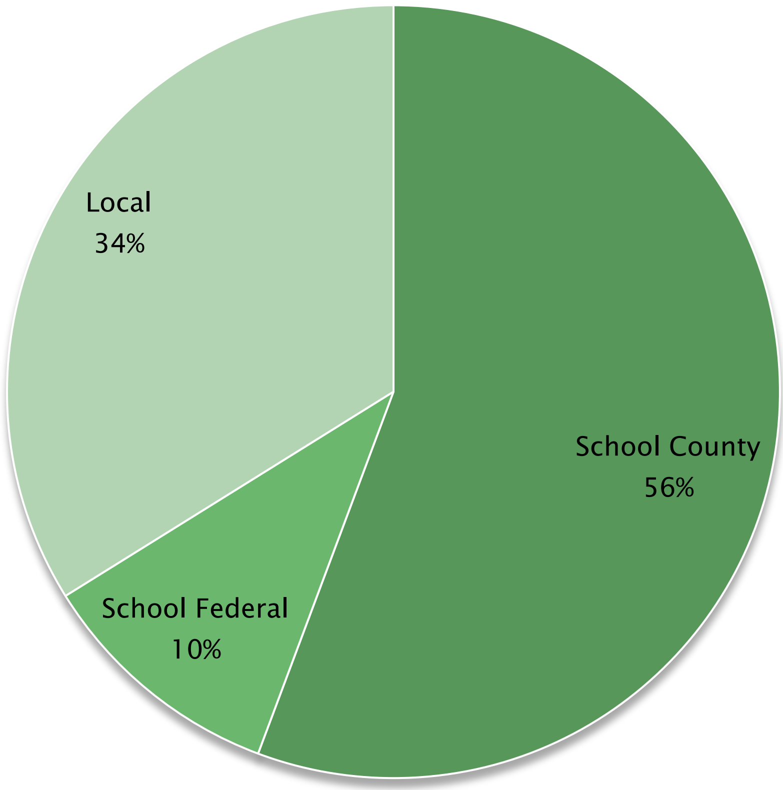
Wages



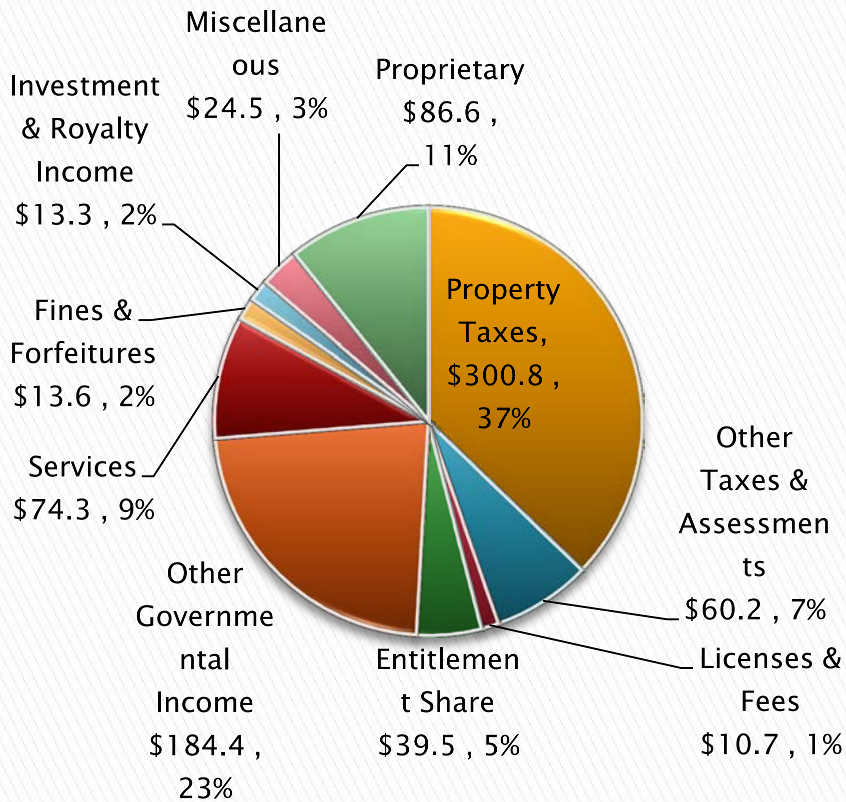
Contributions

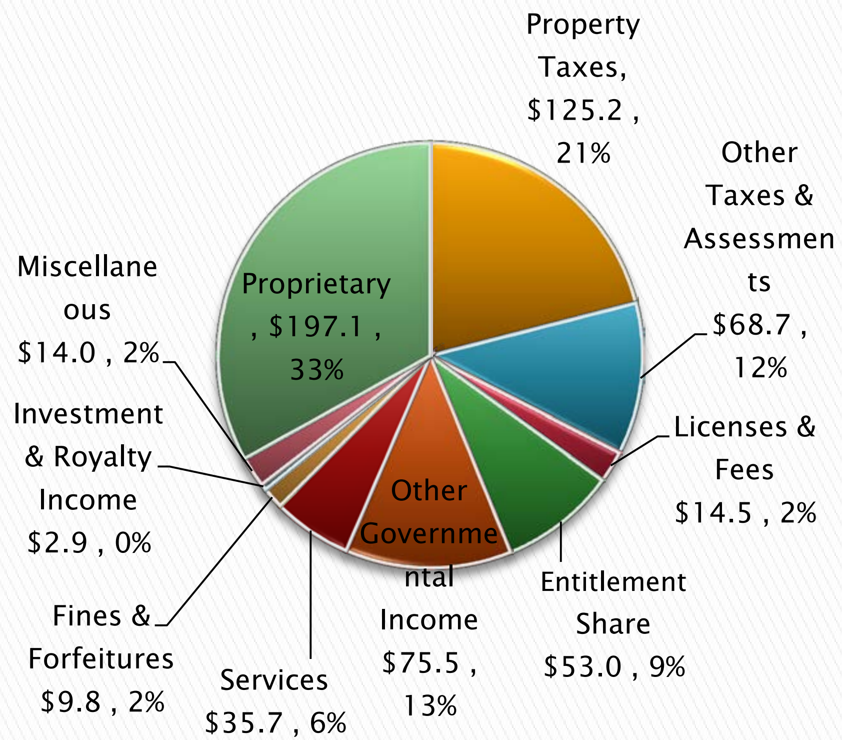


Current School Funding



Local Sources of Funding





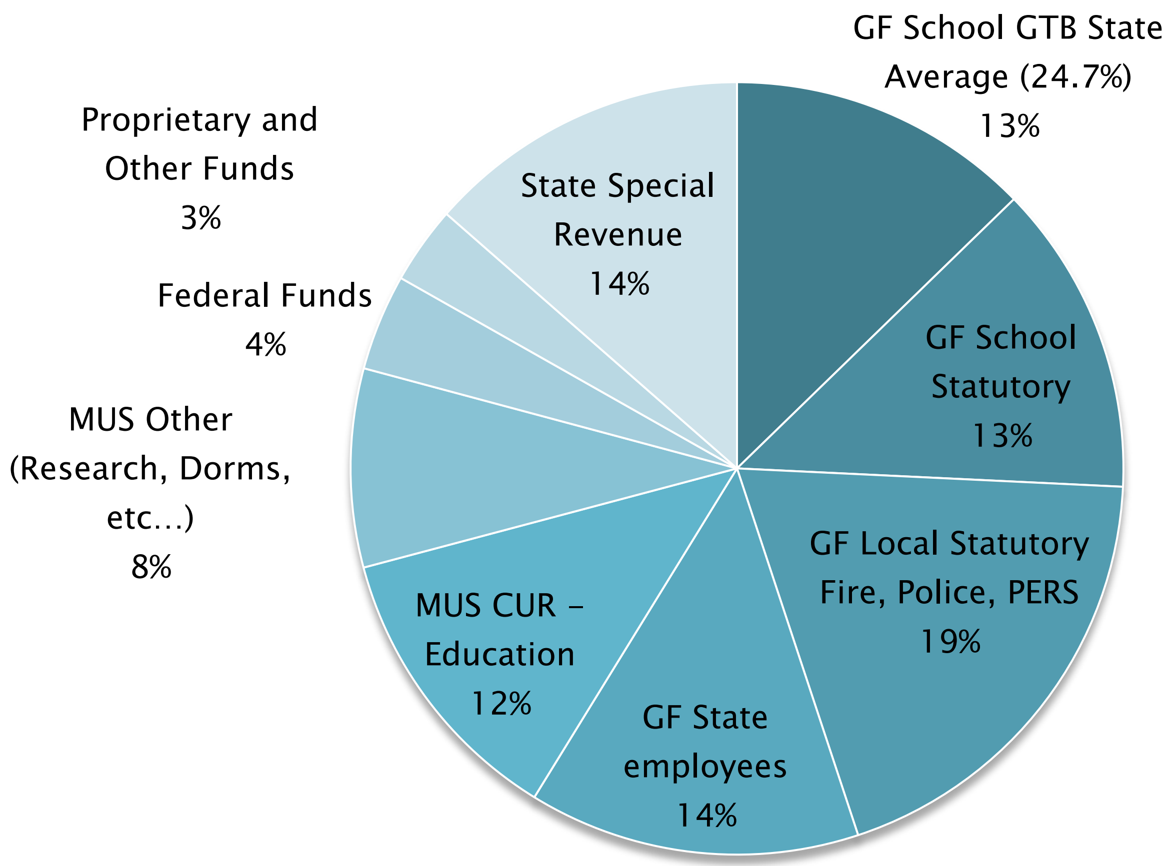
Counties

Cities

School Local Funds

- All marginal funds for K-12 schools pensions comes from Property Tax
- All increases in funding for pensions at the local level come from property taxes

Current State Funding of Pensions

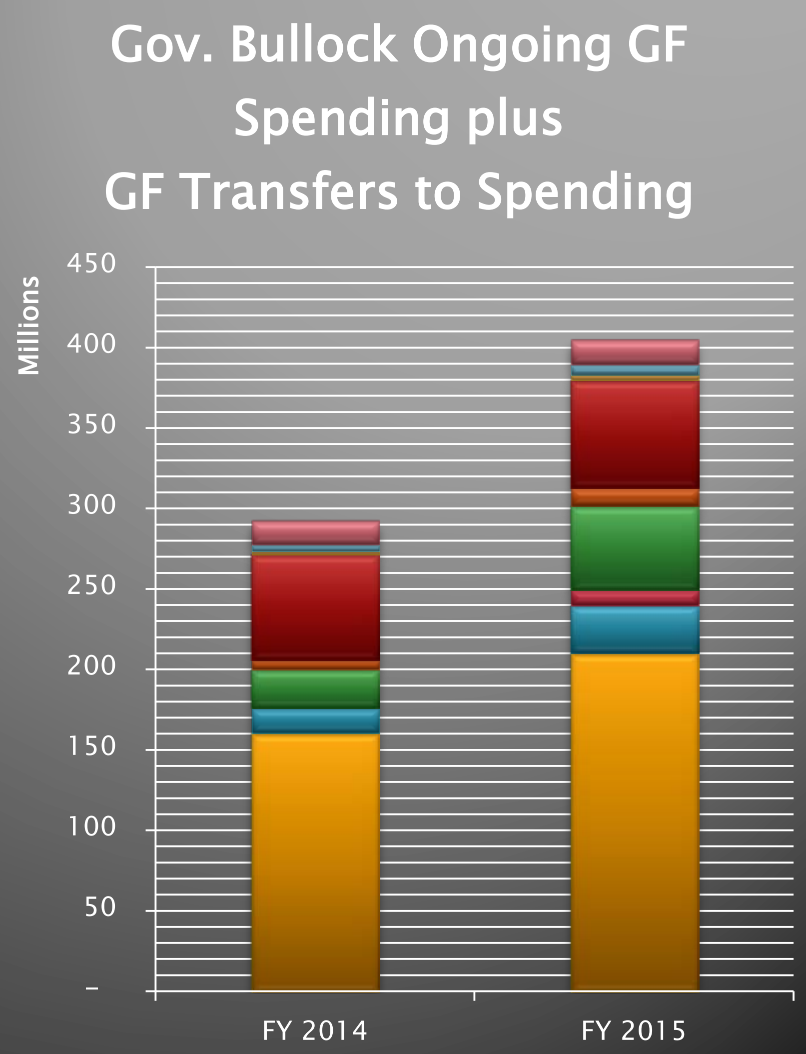


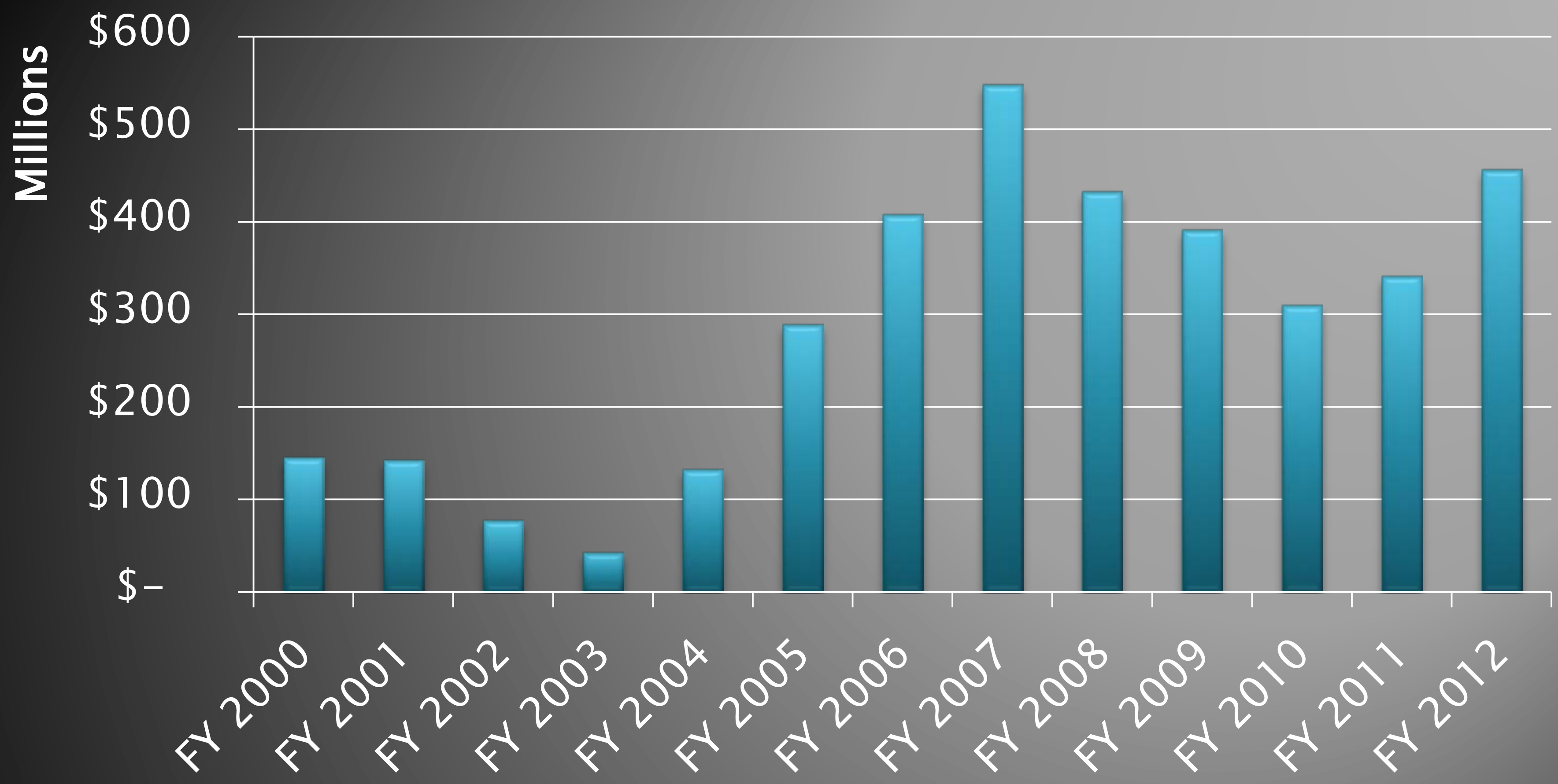
Future Additional Costs

- Several factors influence the allocation of funding for any changes
  - Tuition capacity
  - Local government taxing and fee capacity
  - School taxing and reserve capacity
  - State special revenue and federal funds availability
  - Proprietary funding sources

General Fund Budget

- Pensions are the red block in ongoing spending over FY 2012
- Governor Bullock's budget sets aside approximately $66 million per year for pensions
- Structural balance





GF Ending Fund Balance 12% of biennium

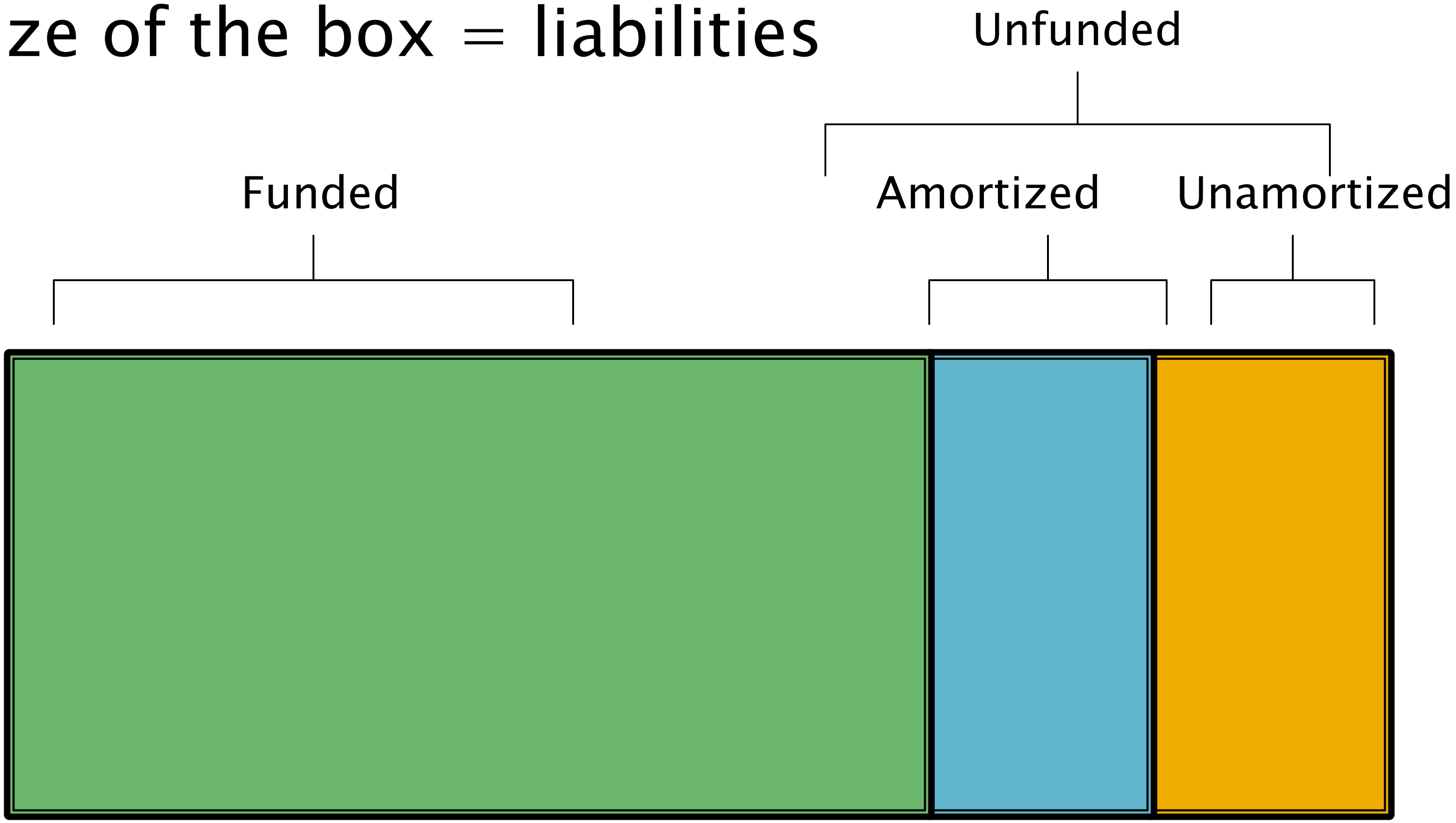
Ending Fund Balance

How big is the Problem: Unfunded Liability (UAAL)

- From UAAL grew from $3.9 billion to $4.3 billion or 10%
- The UAAL is about 50% of total annual spending of state and local governments of about $9 billion
- The shortfall in ARC or $120 million is about 1.3% of the annual spending

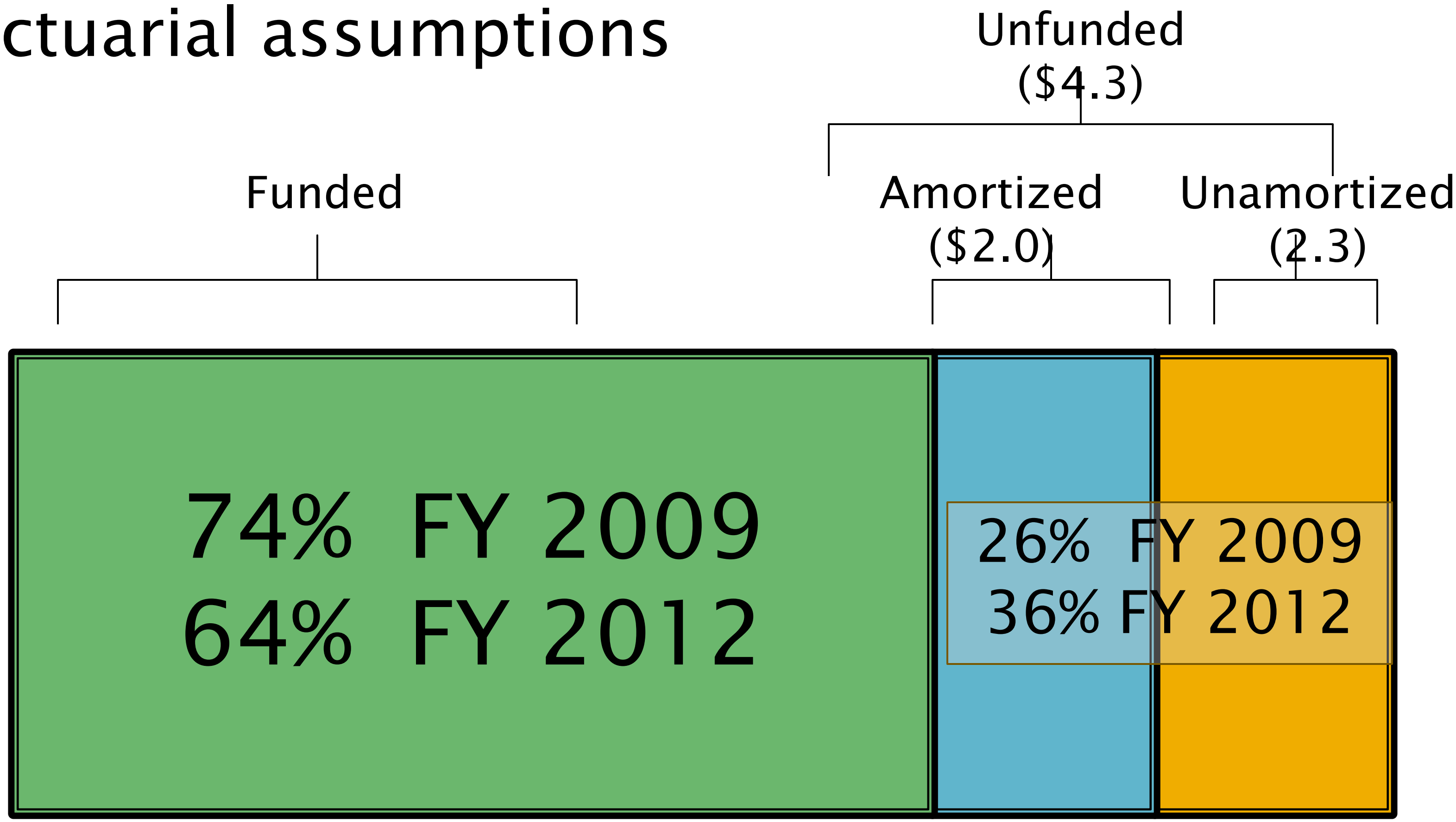
Definitions with Pictures

- Size of the box = liabilities



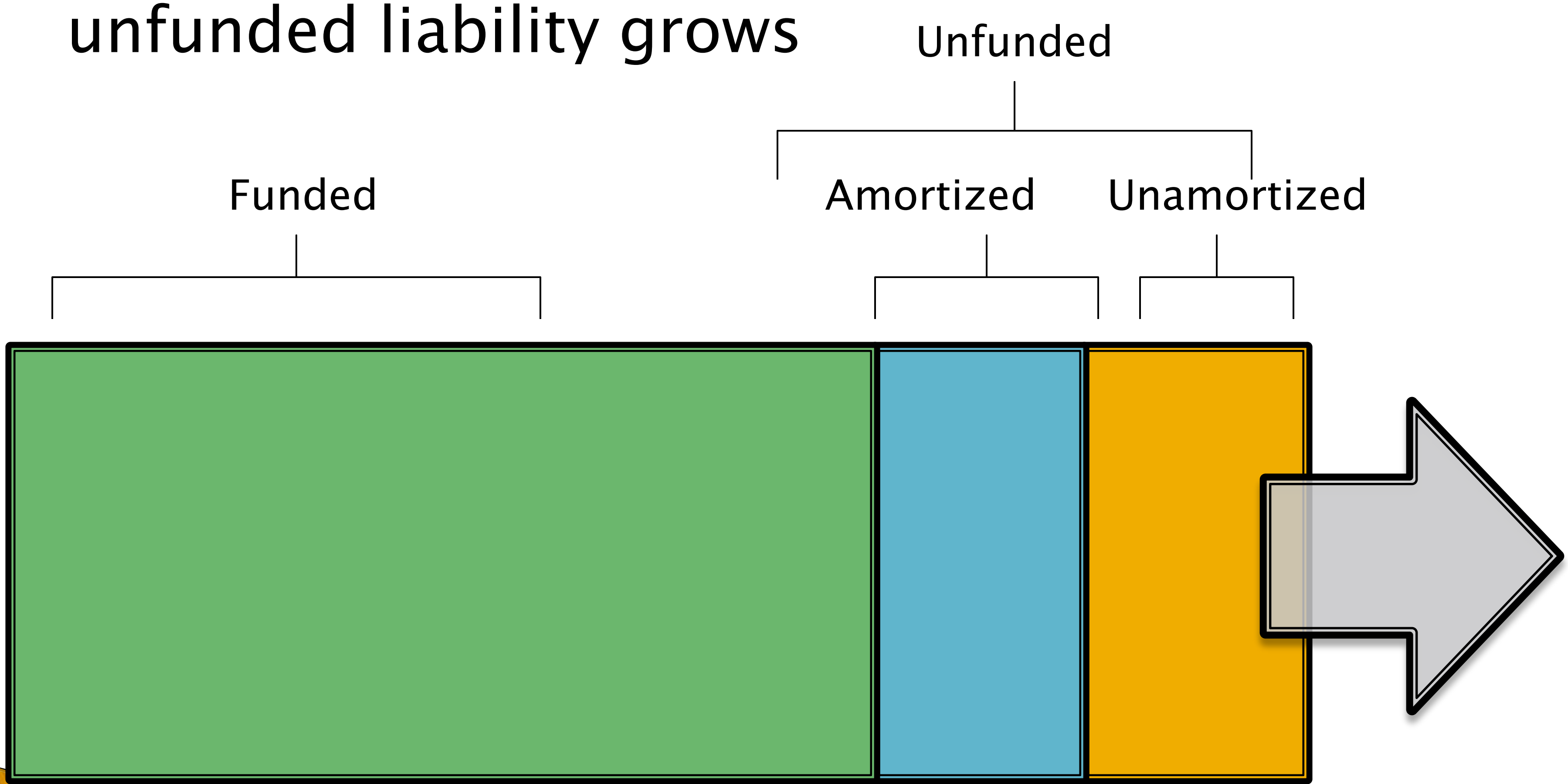
Montana Funding Status: FY 2012

- Actuarial assumptions



Impact of Actuarial Assumptions

- If Actuarial assumptions are not met the unfunded liability grows



Legislature Does Not Set Actuarial Assumptions

- The Constitution gives the responsibility for setting actuarial assumptions to the Pensions Boards
- The Legislature as the financial oversight of the state and local governments needs to be aware of the risks

Changing Landscape

- National Reform in Pension Reporting and Funding Standards

Comparison: Current/New

GASB Funding / Current

- Varying assumptions make comparisons difficult
- Intended to be used for funding
- Maximum 30 year amortization periods for funding
- <u>Discount rate = anticipated ROI</u>
- <u>Liability not distributed to employers</u>

GASB New Accounting

- Comparability is key
- Not necessarily intended to be used for funding
- Accounting amortization periods may be different and shorter
- <u>Discount rate blended</u>
- <u>Distribution of liability to all levels of government</u>
- Will not fully take effect until FY 2015

Rating Agencies – Changes

- Combine retirement liabilities with bonded indebtedness in evaluation
- Allocation of liability among government entities responsible
- Re-evaluate all systems with 7% discount rate and 5 year smoothing

Fitch – Enhancing the Analysis of U.S. State and Local Government Pension Obligations – February 2011

- Combine retirement liabilities with bonded indebtedness in evaluation
- Allocation of liability among government entities responsible
- Value using high yield corporate debt (5.5%)
- 17 year level dollar amortization period

Moody's Summer 2012

Summary of Analysis Changes

- Trend toward more conservative accounting of pension liabilities
- Trend to allocate liabilities to all participating public entities
- Governing article: http://www.governing.com/columns/public-money/col-Pension-Puffery.html

National Effort to Redefine Pension Funding Policy

- National organizations discussing how to create funding standards
- NCSL as a part of the “Big 7” local and state government national organizations has created a Pension Task Force to recommend standard pensions funding rules by reviewing work of national organizations