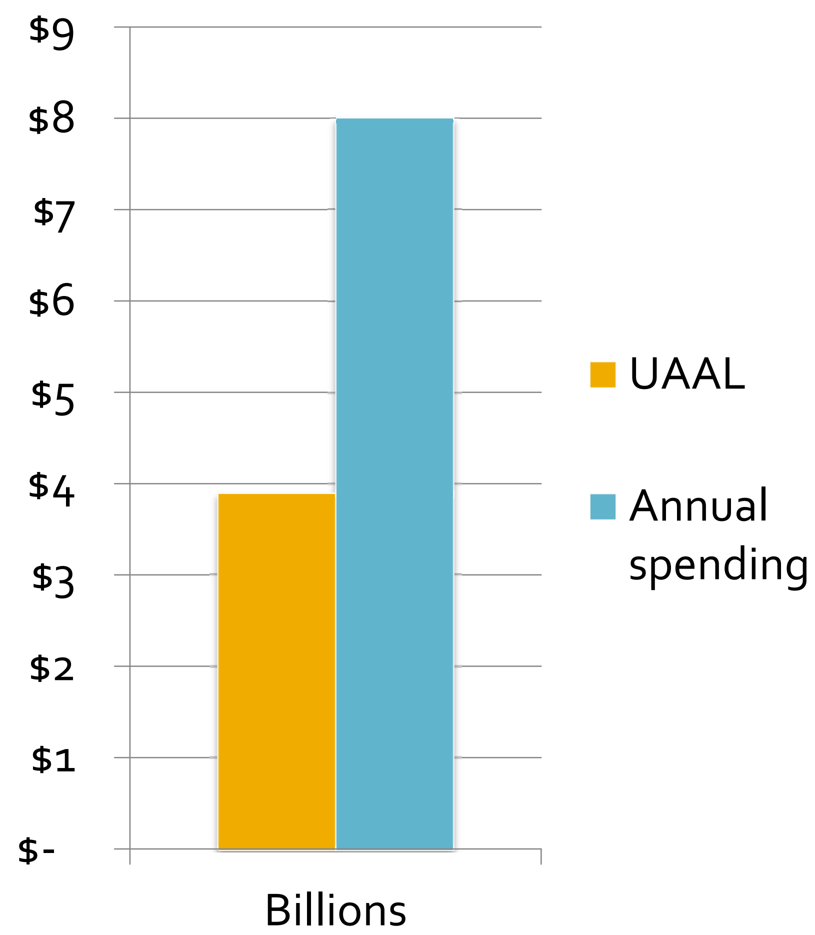
Amy Carlson, LFA to SAVA January 27, 2012

Pension Funding

How big is the Problem: Unfunded Liability (UAAL)

- UAAL grew from $3.3 billion to $3.9 billion or 18%, which is less than anticipated in the FY 2010 Actuarial Analysis
- The UAAL is about 50% of total annual spending of state and local governments of about $8 billion

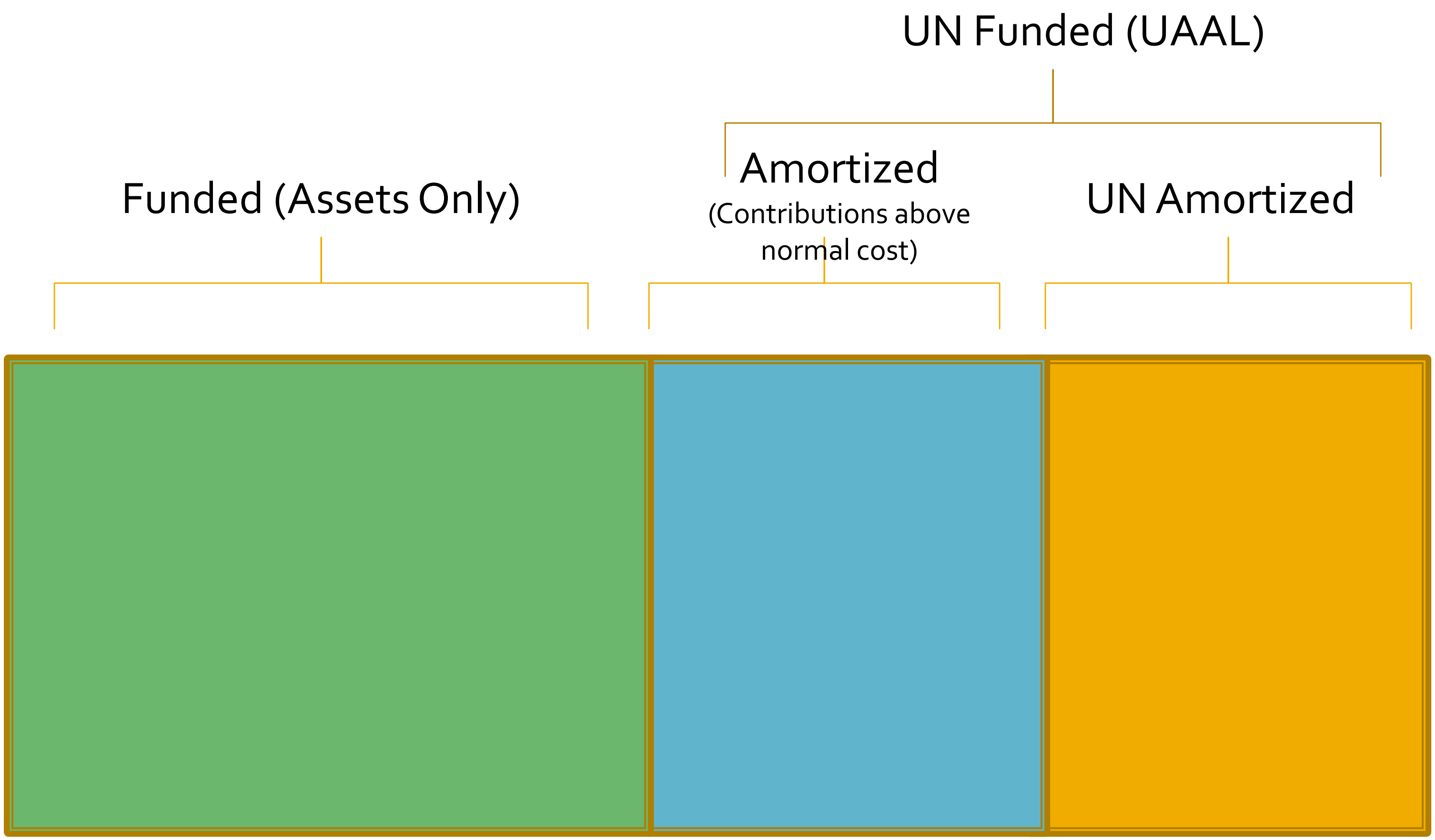


Actuarial Required Contribution

- The shortfall in ARC or $117 million is about 1.5% of the annual spending for state and local governments

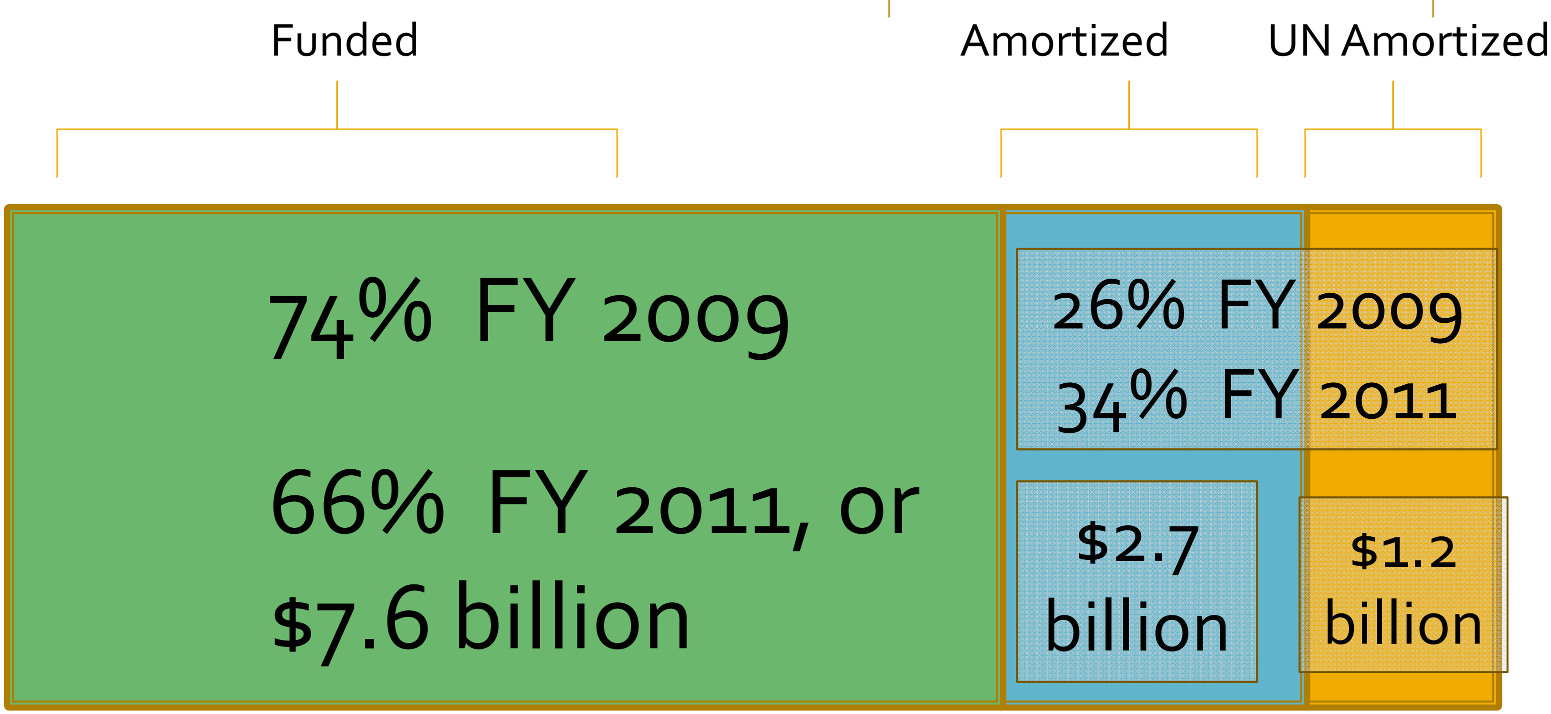
Definitions with pictures

- Size of the box = liabilities



Montana's Funding Status

- Actuarial assumptions



Source: Pew Center on the States: The Widening Gap, data from FY 2009
http://www.pewcenteronthestates.org/initiatives_detail.aspx?initiativeID=85899361051
and Actuarial valuations for FY 2011

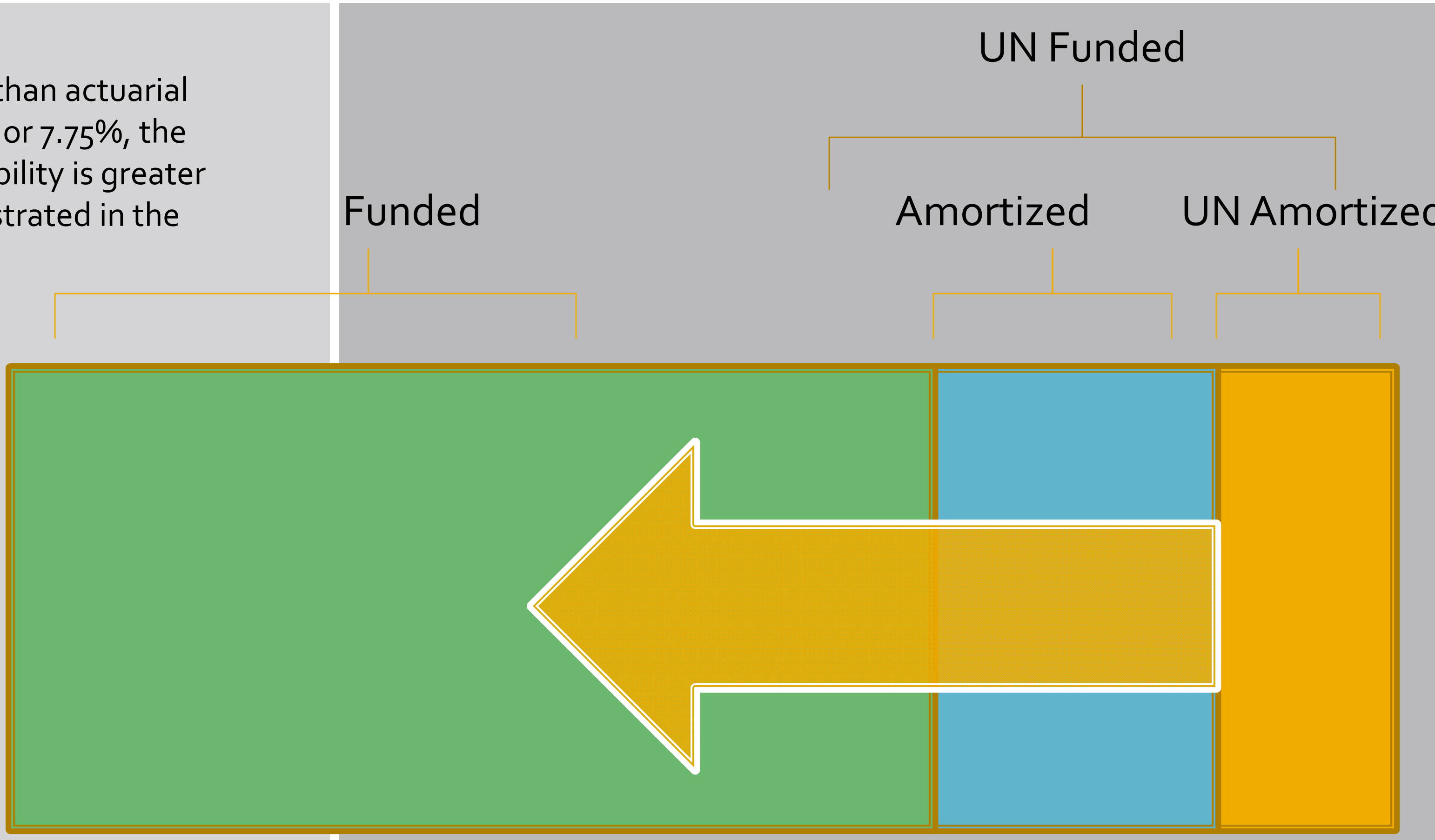
Measuring Financial Risks

Single largest assumption is Return on Investment

ROI

Return on Investment

If ROI is less than actuarial assumptions or 7.75%, the unfunded liability is greater than demonstrated in the analysis



Financial Risks:

- Wilshire, Fitch, and others: ROI may not meet assumptions
- Congressional Budget Office: ROI may not be the right measure

Risk: ROI May not meet assumptions

- Even with Current Asset Allocation ROI may not reach the annual assumed 7.75% ROI
  - Fitch: believes 8% is optimistic and uses 7% in its analysis of pensions
  - Wilshire forecasts a long-term median plan return equal to 6.5% per annum

http://web.wilshire.com/BusinessUnits/Consulting/Investment/2011_State_Funding_Study.pdf

IHS Global Insight

- Last 30 years compounded yield of:
  - S & P 500: about 8%
  - Aaa corporate bonds: about 8%
- Last 20 years and looking forward the next 10 years give compounded yield of:
  - S & P 500: just below 6%
  - Aaa corporate bonds: just above 6%

Is ROI the right measure?

- Congressional Budget Office: Is the ROI the right measure for the discount rate for benefits?
  - Traditional GASB guidelines use ROI for the discount rate
  - Fair value approach: Economists argue riskless rate or around 4% and market value of assets

http://www.cbo.gov/ftpdocs/120xx/doc12084/05-04-Pensions.pdf

Comparing Risk and Liability

Comparison: Current/GASB draft

ACTUARIAL - CURRENT

- Varying assumptions make comparisons difficult
- Intended to be used for funding
- Maximum 30 year amortization periods for funding
- Liability not distributed to employers

GASB EXPOSURE DRAFT

- Comparability is key
- Not necessarily intended to be used for funding
- Accounting amortization periods may be different and shorter
- Distribution of liability to all levels of government
- Will not take effect until FY 2014

Rating Agencies - Changes

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
- Re-evaluate all systems with 7% discount rate and 5 year smoothing

MOODYS COMBINING DEBT AND PENSION LIABILITIES OF U.S. STATES ENHANCES COMPARABILITY – MARCH 2011

- Combine retirement liabilities with bonded indebtedness in evaluation
- Allocation of liability among government entities responsible
- Continuing with currently reported valuations, though recognizes limitations

Fitch Change in Funded Ratios as of FY 2009: An Example

CURRENT - 2009

- PERS – 83.5%
- TRS - 66.2%
- New York Employees – 101.0%
- West Virginia Teachers – 41.3%

FITCH – PROPOSED FY 2009

- PERS – 72.3%
- TRS – 61.7%
- New York Employees – 92.9%
- West Virginia Teachers – 32.9%

Standard and Poor's measures of risk – no changes announced

- Pension funded ratio: **Below average (3)** 60%-80% (FY 2011 66%)
- Pension funding levels: **Above average (2)** Funds ARC in most years but occasionally contributes less.
- Unfunded pension liabilities/capita: **Weak (4)** Above $3,500 ($3.9 billion / 1 million)
- UAAL relative to personal income: **Weak (4)** Above 7% ($3.9 billion / $34.7 billion FY 2010)

Summary of Analysis Changes

- Trend toward private accounting of pension liabilities
- While it is important to pay attention to the potential to affect of these changes, the details as they are continuing to change
- Governing article: http://www.governing.com/columns/public-money/col-Pension-Puffery.html

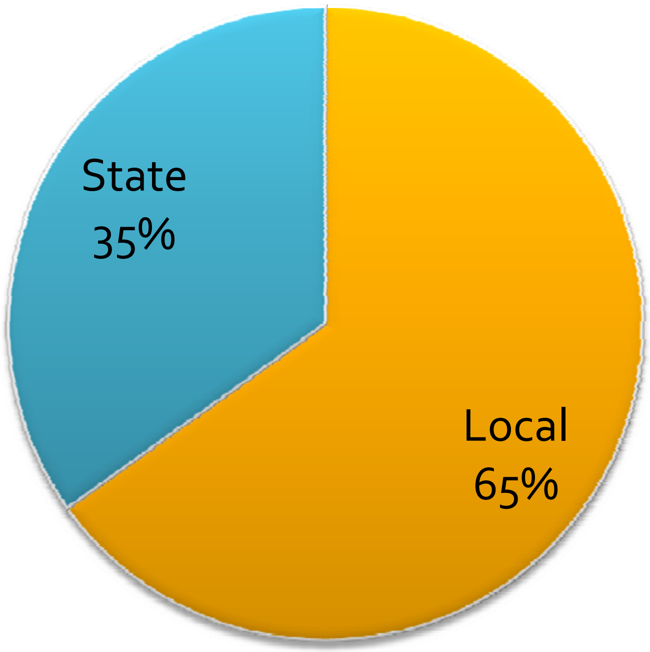
Allocation of Cost using Employer Contributions

Comparison Using Employer Contribution Rate Increases

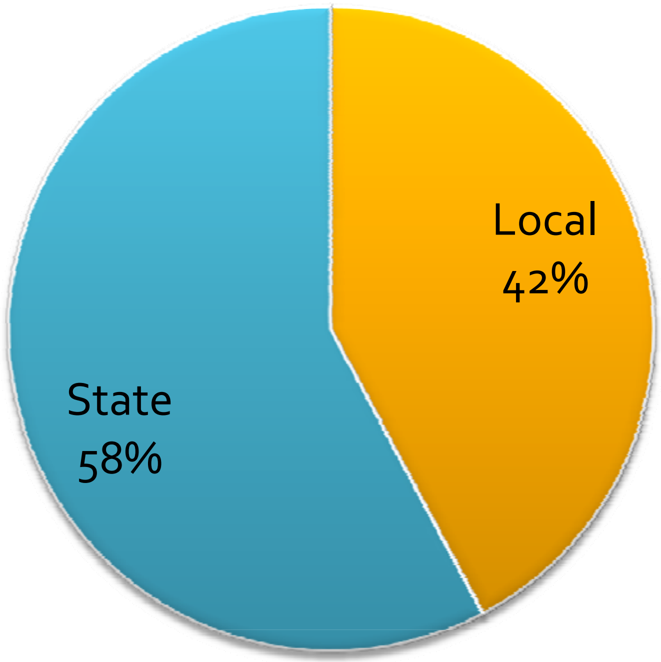
- Allows for comparisons between levels of government
- Not offered as a solution to the problem
- Solutions will likely use a combination of measures to resolve the issues
- First draft of numbers, fine tuning of all will change

FY 2011 Wages & Retirement Contributions

WAGES



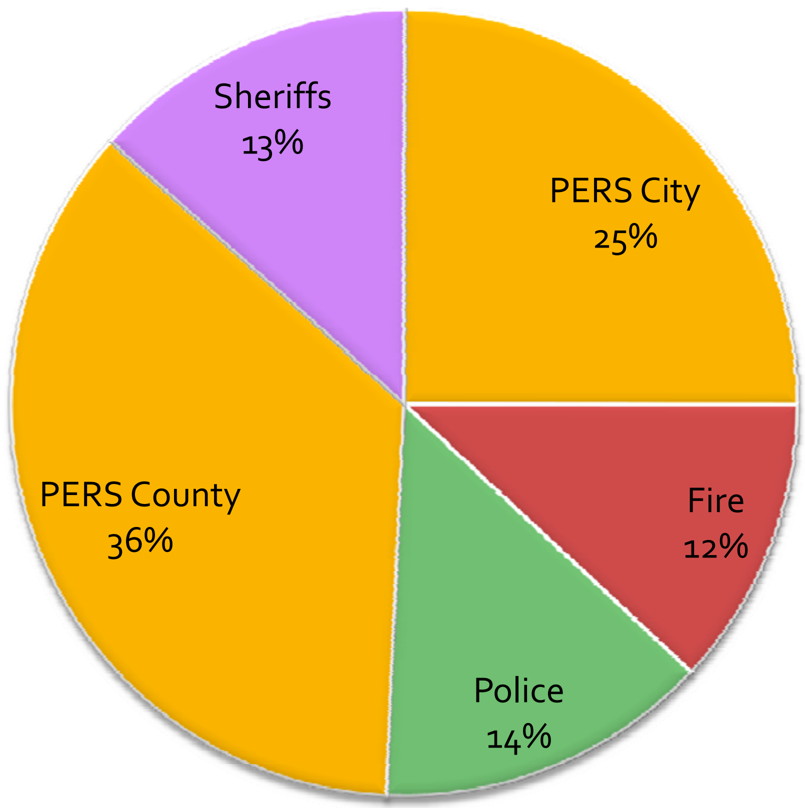
CONTRIBUTIONS



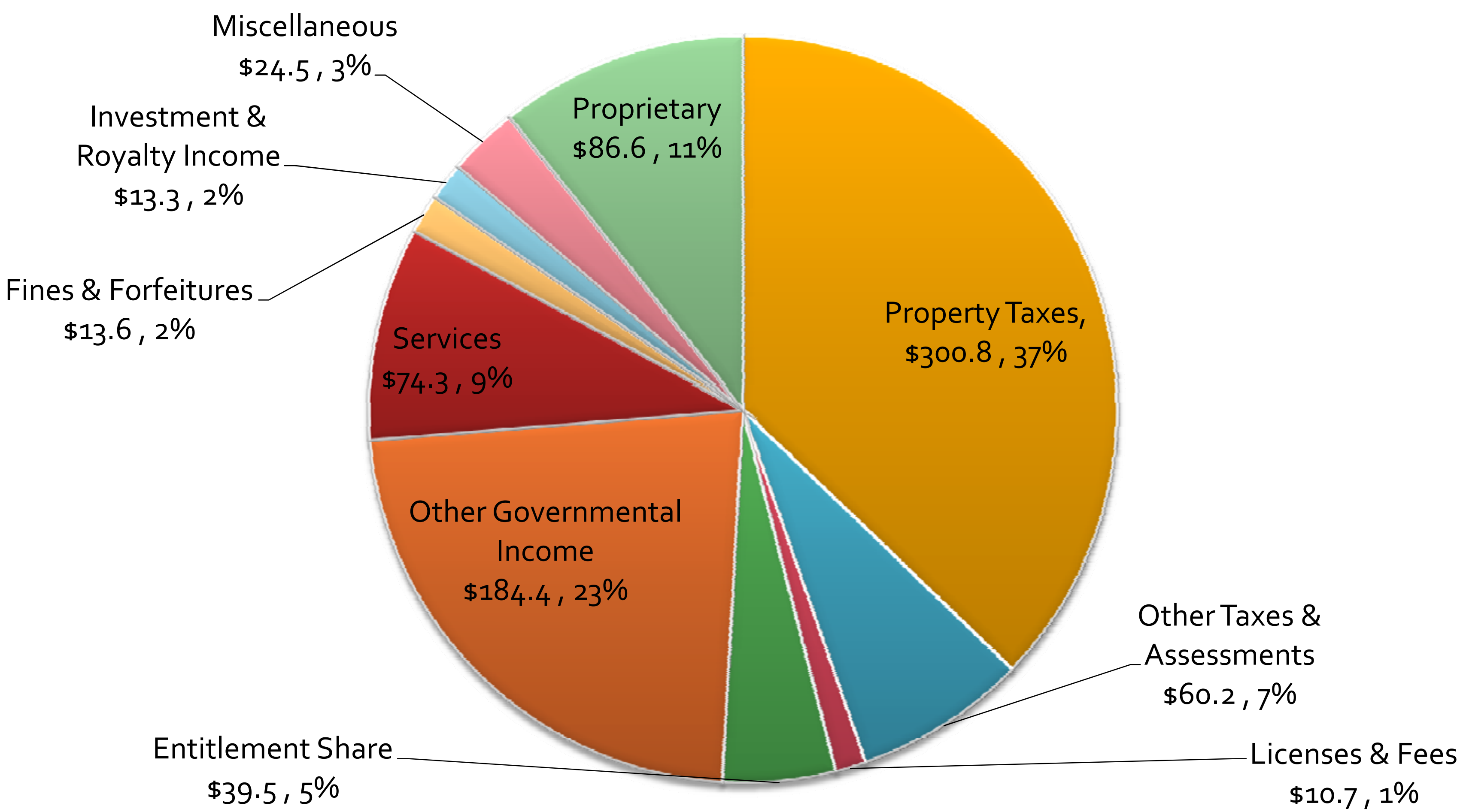
Systems

- Counties
  - Sheriffs
  - PERS
- Cities
  - Fire
  - Police
  - PERS

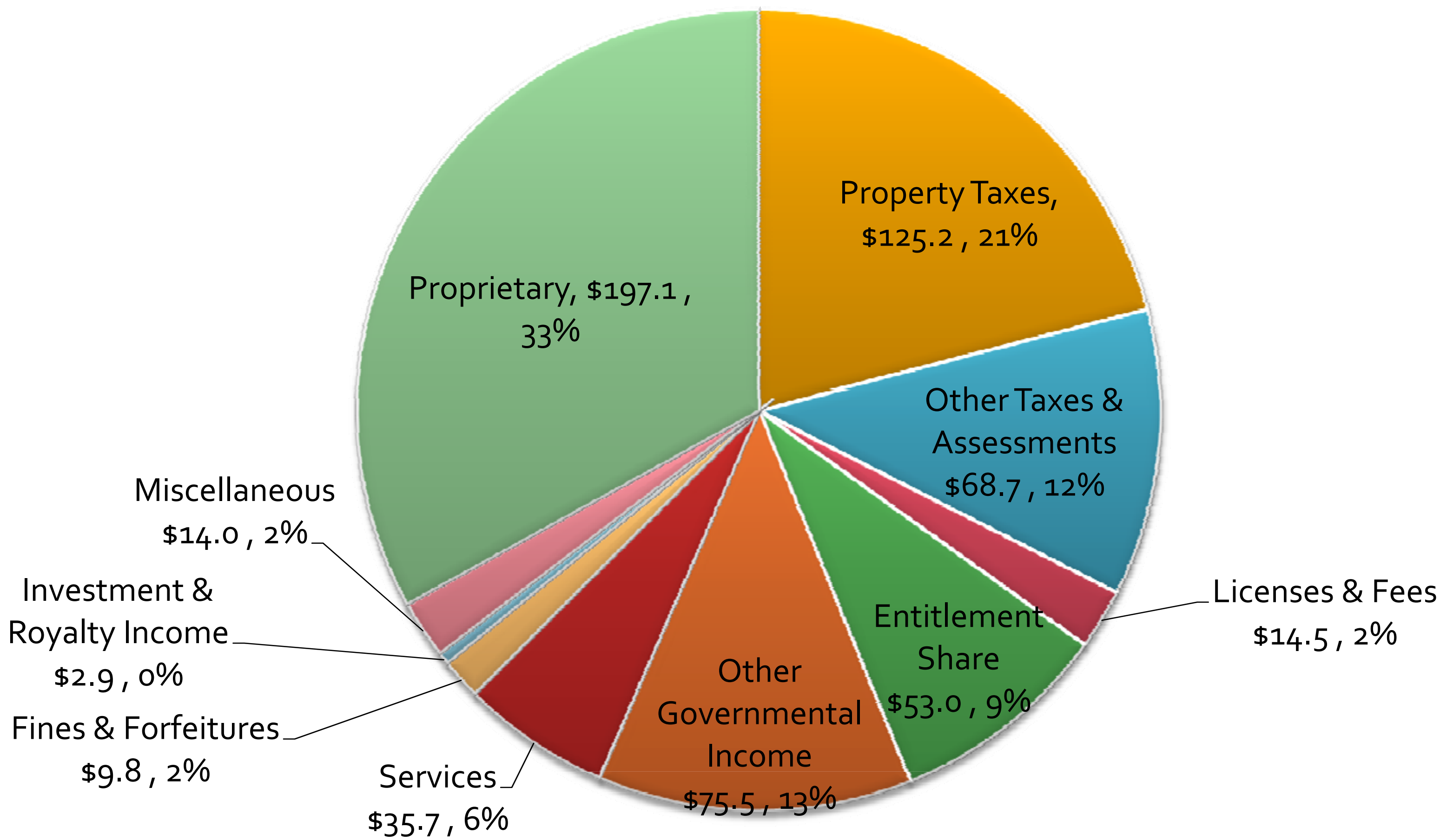
Total City & County Employer Contributions



Pension Participating County FY 2010 Revenue ($ millions)



Pension Participating City
FY 2010 Revenue ($ millions)



Estimates of Closing the ARC gap with Employer Contributions

- Cities: 1.1% of annual expenditures
- Counties: 1.7% of annual expenditures

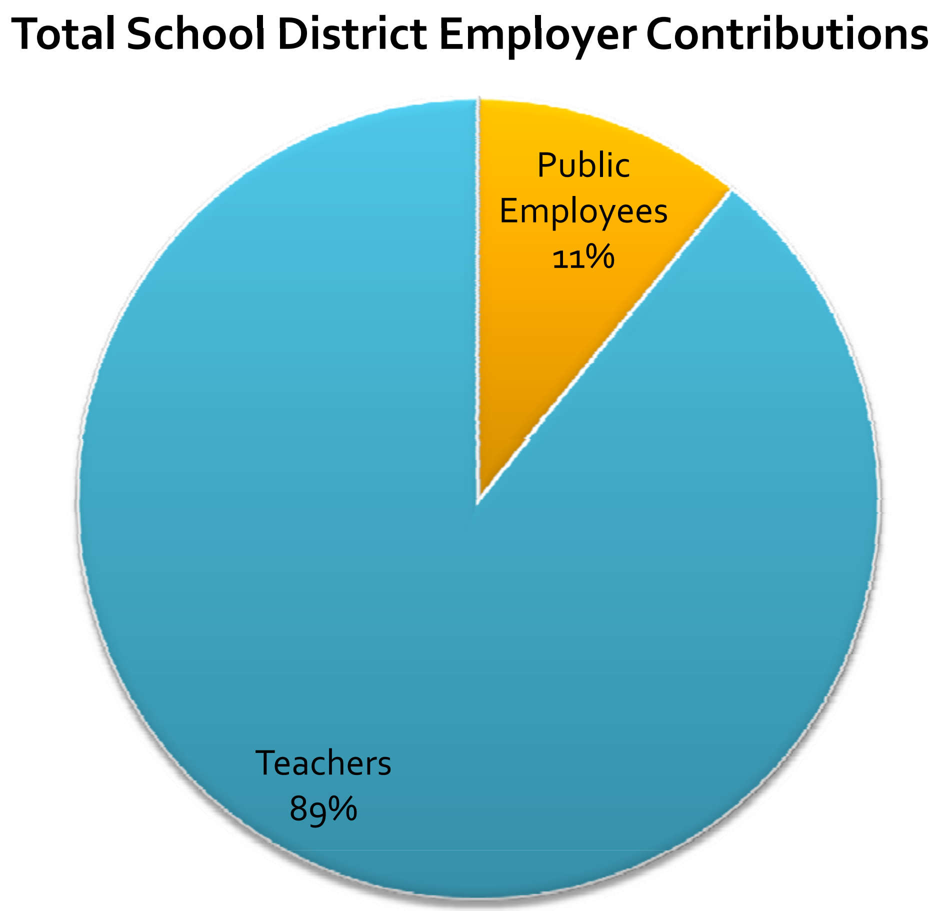
Property Tax

- Under current law counties and cities may be able to increase levies up to the limits of MCA 15-10-420, if they have capacity within the levy
  - Maximum if levies could float to cover all increased costs: $24 million
  - Maximum if levies could float to cover estimated property tax share of increased costs: $7.5 million

Local Schools

Systems

- Schools
  - TRS
  - PERS



Definition of a Quality Education

- MCA 20-9-309 ...(2) As used in this section, a "basic system of free quality public elementary and secondary schools" means: ... ...(d) qualified and effective teachers or administrators and qualified staff to implement the programs in subsections (2)(a) through (2)(c); ...

Estimates of Closing the ARC gap with Employer Contributions

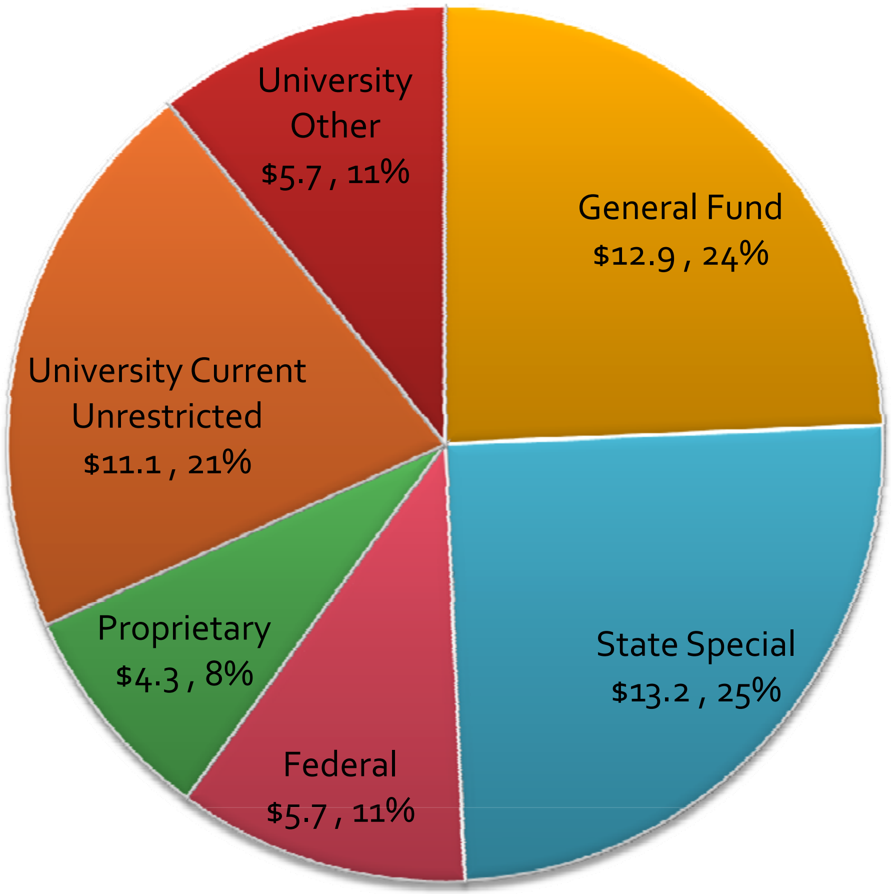
- The gap in the ARC if paid with employer contribution rate increase is 2.77% of school district budgets (Page 12 of report)

Property Tax

- Using the current funding formula
  - Federal funds would need to absorb 12% or $4.7 million
  - Local levies would increase $26.2 million
  - State Guaranteed Tax Base aid would increase $9.1 million

State Government

State Impact of Meeting the ARC: FY 2014 Potential Increase ($ millions)



Total General Fund $19.3 million for state employees (note GTB is additional):
- ✓ $12.9 million GF employees,
- ✓ $1.4 million proprietary employees,
- ✓ $5.0 million MUS employees

Summary of Employer Contribution Impacts

- State General Fund: $28.4 million
  - $12.9 million state general fund employees
  - $1.4 proprietary employees
  - $5.0 million MUS employees
  - $9.1 million school employee GTB aid
- Other MUS funds: $11.8 million
- Other state funds: $21.8 million
- School property taxes: $26.6 million
- Local government costs $24.0 million

Next Steps

SAVA and
LFC meeting
June 12, 2012

- Combined Legislative Services and Fiscal analysis
  - Policy
  - Legal
  - Funding policy
  - Financial Risk
- Understand the pension system proposals
- Continue to refine work to date