

MAJOR FISCAL ISSUES FACING THE LEGISLATURE

PENSION FUNDING SHORTFALL

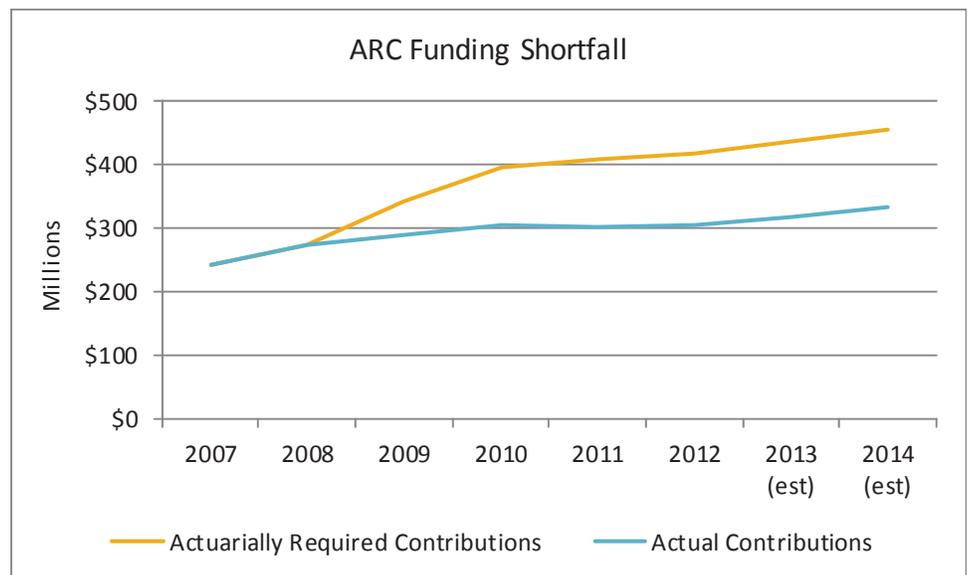
Five of Montana’s eight public pension systems face significant funding shortfalls due in combination to a prolonged period of low investment earnings and the lack of sufficient legislative actions to increase state, employee, or employer contribution levels in these times of extended economic downturn. Following is a brief description of this issue.

Constitutional Obligation

Article VIII, section 15, of the Montana constitution requires the state’s public retirement systems to be funded on an “actuarially sound basis”. Four of the five systems facing shortfalls are governed by the Montana Public Employees’ Pension Act, wherein “actuarially sound basis” is defined to mean that contributions to each plan must be sufficient to amortize unfunded liabilities over a scheduled period of no more than 30 years (19-2-409, MCA). All five of Montana’s troubled pension systems do not meet this standard, and four are actuarially projected to eventually become insolvent at current contribution levels.

Funding Shortfall

Montana’s two largest public pension systems, the Teachers’ Retirement System (TRS) and Public Employees’ Retirement System (PERS), are responsible for over 90% of the State’s funding shortfall. As of June 30, 2012, the actuarially-determined Annual Required Contribution (ARC) to amortize the unfunded liabilities for all five troubled systems over a 30 year period is approximately \$112 million per year higher than the current level of contributions to the systems. This annual shortfall is projected to increase to over \$121 million by the beginning of the next biennium.



The typical pension system is funded from three sources: employee contributions, employer and state contributions, and investment earnings. Historically, about 60% of the total funding comes from investment income, with the remainder coming from employees, employers and the state. A prolonged period of insufficient contributions into the system will eventually cause the investment portfolio to increase its proportion of highly-liquid but lower-return assets in order to directly pay retirement benefits, further driving down investment returns to the detriment of the systems overall health.

What Can Be Done To Fix The Problem?

The “problem” is too few funds coming into the system, through new contributions and investment earnings, versus projected future benefits to be paid from the system. This problem can be addressed in a number of ways including but not limited to increased contributions into the systems, reduction in benefits from the systems, changes in pension offerings to new employees, or combinations of all three. A long-term solution will not only serve to close the existing funding gap but will also position the pension systems to reasonably manage risks moving forward – so that the likelihood of the “problem” reoccurring is reduced.

Is Legislative Action Needed?

That is a decision for legislative policy-makers. Contribution rates, supplemental State support and plan benefits are set in statute. Legislative action is required if policy-makers desire to address the pension funding shortfalls by increases in contribution rates, reductions in benefits, changes for future employees, or other actions meant to change the existing retirement system statutes.

Paramount to any legislative decision is the need to understand the legal and constitutional issues associated with public pensions. Contract impairment issues are subject to the U.S. and Montana Constitutions and must be thoroughly considered. As legislative committees and individual legislators begin to focus their ideas, staff are ready to assist in analyzing the ideas through the four lenses--legal, policy, funding, and financial--and translating the ideas into legislation if desired.

Proposed Legislation

A number of bills will be before the 2013 Legislature related to pension system reform including proposals by the Governor, various legislators, Teachers' Retirement System, Public Employees' Retirement System, and various stakeholder groups. Legislative research, fiscal, and legal staff have spent much time during the interim evaluating current statutes and available options and will be available during session to assist legislators upon request. For further information on interim pension activities, visit the following web pages:

<http://leg.mt.gov/css/fiscal/Pensions.asp> and

<http://leg.mt.gov/css/Committees/Interim/2011-2012/State-Administration-and-Veterans-Affairs/default.asp>